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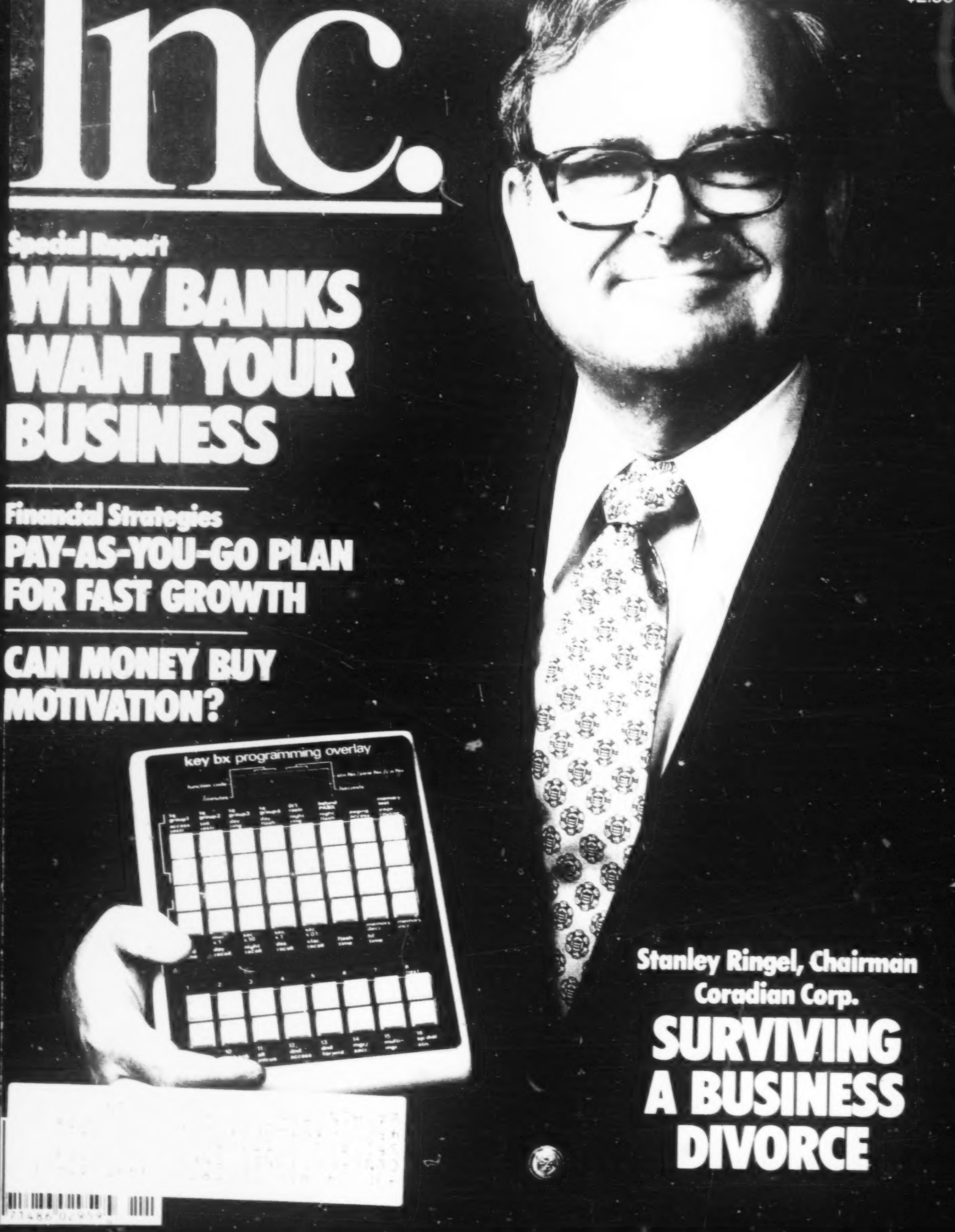

Special Report

WHY BANKS WANT YOUR BUSINESS

Financial Strategies

PAY-AS-YOU-GO PLAN FOR FAST GROWTH

CAN MONEY BUY MOTIVATION?

Stanley Ringel, Chairman
Coradian Corp.

SURVIVING A BUSINESS DIVORCE

NOVEMBER 1981

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Peter Jones

Ringel and Schwartz of Coradian Corp.

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Cover photo
Peter Jones

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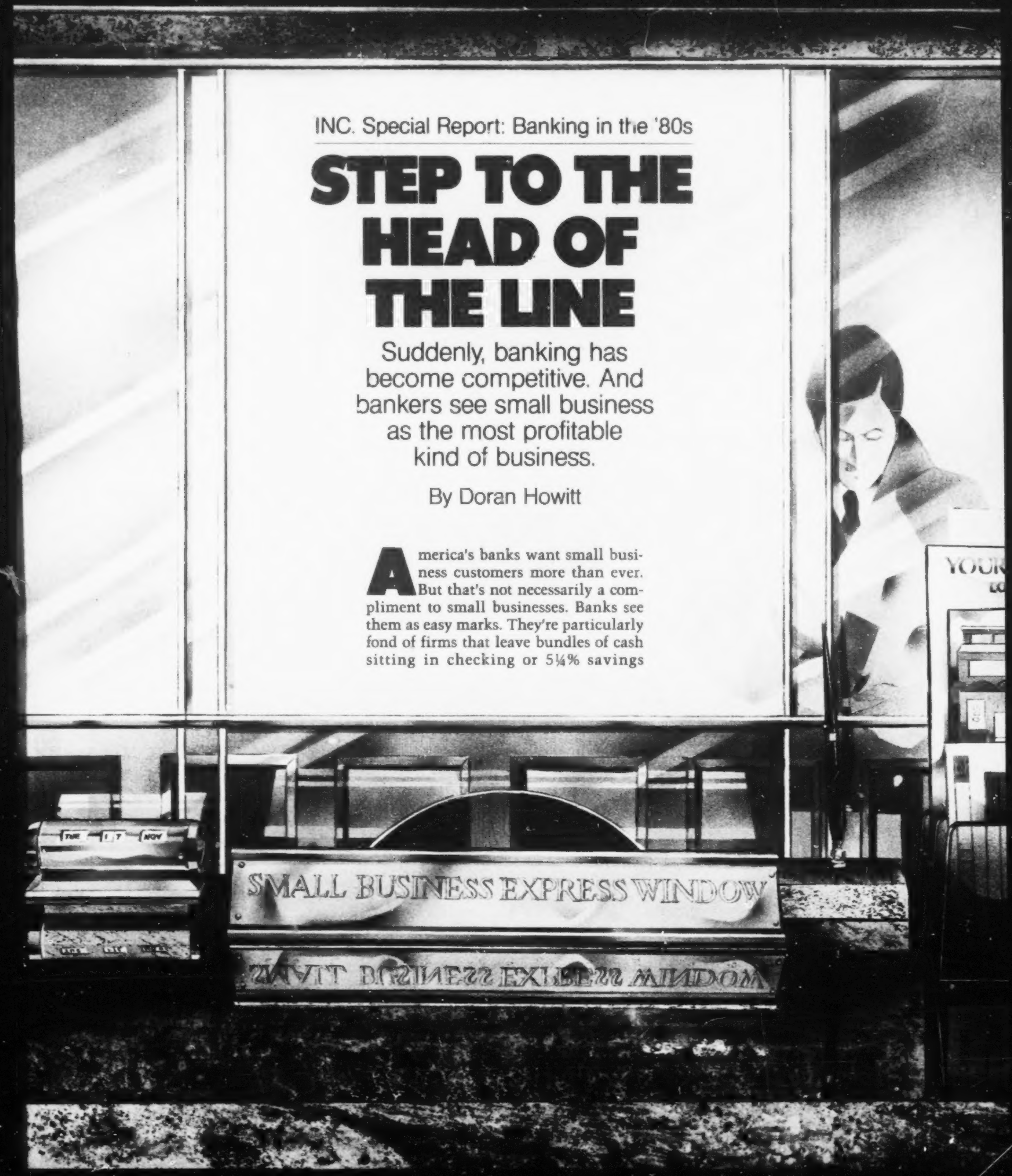

INC. Special Report: Banking in the '80s

STEP TO THE HEAD OF THE LINE

Suddenly, banking has become competitive. And bankers see small business as the most profitable kind of business.

By Doran Howitt

America's banks want small business customers more than ever. But that's not necessarily a compliment to small businesses. Banks see them as easy marks. They're particularly fond of firms that leave bundles of cash sitting in checking or 5¼% savings

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PRIME
Information Systems

accounts—cash on which the banks earn 15% to 20%.

In the 1960s and 1970s, America's money-center banks and large regional banks couldn't be bothered with small companies. Why fuss with $50,000 loans when you can swing $50-million corporate deals for the same trouble or when you can syndicate loans in the hundreds of millions of dollars to foreign institutions and governments?

In the mid-1970s, though, that game started to change. Larger corporations learned how to sell commercial paper, bypassing the banks and eliminating their middleman's markup. When interest rates started climbing in the late 1970s, these corporations also grabbed back valuable dollar balances that they had let sit in checking accounts, investing them instead in repurchase agreements and other high-yielding investments, even if the money was available only as long as overnight. Also foreign banks, more lightly regulated and more highly leveraged than ours, began usurping U.S. strongholds by lending Eurodollars to multinational corporations at rates that U.S. banks couldn't match. Compared with that abuse, this country's vast ranks of small companies reward their bankers generously.

Tom Barr/Black Star

Ford: Two years ago, Mellon wasn't paying much attention to small business.

So now small businesses find themselves the center of attention. Jerome L. Roderick, director of the domestic lending division for Robert Morris Associates, a national organization of commercial loan officers, sums up the bankers' dilemma: "Ten years ago, a banker would sit back and wait for customers to come in the door. Now he has to go out and compete."

Mellon Bank in Pittsburgh, for example, has joined the fray. Only two years ago Mellon wasn't paying much attention to small business, according to Craig G. Ford, senior vice-president in charge of community banking. Mellon is a major international player and is this country's 16th largest bank by assets, but it also operates 110 branches in the six counties where Pennsylvania law allows it. Now it has formed a new division to pursue small companies in this territory.

Mellon has designated five officers at its headquarters to specialize in small business loan structuring and credit analysis. They help out whenever a branch lending officer runs into a small business loan application too puzzling to handle alone. "If you can generate the volume, you can allocate some specialists into the field," Ford says.

Even though the attention may be a lefthanded compliment, this new fad among bankers has meant some good news for small borrowers. Among the shifts occurring in the industry:

☐ Small firms are getting relatively better rates. That's perhaps hard to believe when the prime tops 20%. But they seem to be paying less of a premium over prime than they used to.

☐ Banks are abandoning short-term, roll-over credits in favor of longer-term commitments to their good customers. That allows borrowers to count on a line of credit for five or more years, without worrying that it could disappear at a loan committee's whim. What used to be short-term seasonal loans become medium-term working capital financing.

☐ For the first time, banks are designing cash management products and other electronic services specifically for small firms. Eventually, the advances in this field will bring to small companies the same savvy techniques that the large companies already use with such success.

In theory, stiffer competition drives down prices. The average price for borrowing money, of course, hasn't fallen during the past few years. But small business may be getting better rates than it used to compared to big business. Nobody says for sure, though, because interest rates alone don't necessarily mean anything. Compensating balance requirements make effective interest rates higher than what loan contracts state. And then there's the hubbub over whether prime rates are really prime: Some banks treat them just as bargain-

(continued on page 42)

Illustration on page 39 by Bunny Carter

ing chips in negotiating loans with large companies rather than as base lending rates.

Keeping in mind those caveats, the spread that small firms pay over prime has narrowed or even disappeared. Five years ago, according to Federal Reserve Board figures, loans of less than $100,000 commanded a couple of percentage points more than loans of $1 million and up. Today, according to the same statistics, the differential is nil. And that isn't just a figment of some federal statistician's imagination. Borrowers have noticed the change. In a survey of almost 1,000 INC. subscribers conducted last winter, small firms said their latest loan was, on average, within one-half point of prime.

"For middle-market companies, the cost of credit has decreased compared to large corporations," says Richard S. Bibler, executive vice-president of First Wisconsin National Bank of Milwaukee. "The risk premium has decreased. Where the premium for small corporations may have been three points above prime, now it's one point. The small business borrower may really be getting a bargain now."

That's going overboard. Nobody thinks a 20% prime rate is a bargain. But it's better than 23%. Federal Reserve Board economist Thomas F. Brady theorizes that bankers have hesitated to pass on the full burden of rising interest rates to small businesses. Instead, he suggests, they follow a "longer-run, profit-maximization strategy," which means helping your customers stay afloat during difficult times so that you'll still have customers when times get better.

"Historically, small business has paid a higher rate because of risk," says David A. Wollard, president of Florida's Southeast First National Bank of Miami. "But if a business was paying two points over prime when the prime was 10%, you just can't afford to charge him two over prime when the prime is 20½%. You can charge that, but the business will fail and you'll have a bad loan on your hands. So discretion being the better part of valor, you back off on the rates."

There are other plausible explanations. For one thing, a higher proportion of loans to small firms carry fixed rates than do loans for big companies. When interest rates rise, therefore, small companies' rates don't float upward as fast.

In addition, smaller banks, which lend mainly to small companies, tend to charge less than large banks whenever interest rates are rising. D. Bruce Adamson, chairman of the First National Bank and Trust Co. of Joplin, Mo., points out that this has been so since the Federal Reserve Board first allowed banks to sell six-month money market certificates to consumers in 1978. For smaller banks, these have since become a staple source of funds, locking in their costs for six months in advance. Larger banks, on the other hand, buy most of their funds at the going rate in very short-term money markets. When interest rates rise, small-bank rates lag behind. In August, when the big-bank prime was 20½%, Adamson was charging 18½%. Obviously, when rates fall, the advantage switches to the other side.

Steve McCurry/Gamma Liaison

Roderick: "The businessman is going to have a lot more to choose from."

The renewed competition has spurred banks to help ease economic pressures on small business in other ways.

For instance, banks are offering more medium-term revolving lines of credit for working capital, in place of the standard 90-day notes. Typically, these are committed for one to seven years, though often secured by short-term assets such as receivables or inventory. "It's really a kind of long-term financing," says Roderick of Robert Morris Associates. "There's a source of capital available continuously to finance growth. It isn't called that. But it's done with an eye to getting the company up where it can get out of its working capital pinch."

Pennsylvania's First National Bank of Mercer County has started making loans like that. "Some of our revolving lines are running out to five years on a formula basis against receivables and inventory," says Stephen J. Gurgovits, executive vice-president. "We're getting away from 30-, 60-, and 90-day notes, away from due and payable in six months and rolling them over. At least one-third of our loans are structured like this now, and I expect that to grow to one-half by 1982.

"Financing now is more geared to be compatible with the cash requirements of the business," he says. "We've come through a very inflationary period, and if you take a business that's inventory-intense, its demands for credit actually have been growing. If you're financing its inventory needs or its general working capital needs and you're putting on 90-day notes, I think you're only kidding yourself. The company's needs for financing are growing, and you're trying to convince yourself that it's going to be a liquidating situation.

"We've also completely eliminated the need for annual cleanup," adds Gurgovits. "Cleanup just provides the opportunity for the bank across the street to extend our customer the credit."

John R. Barrick, one of Gurgovits's customers, switched from short-term notes to a seven-year revolving line of credit for an amount "well into six figures." Barrick, a metallurgical engineer, founded his metal recycling company, Pyromet Technology Inc. of Greenville, Pa., in 1978 and says annual sales are now about $7 million. "Before," says Barrick, "each time we required money, I would have to go in and sign a note. It took a great deal of time and effort, inconveniencing both the bank personnel and myself. Now we have a line of credit committed for seven years, secured by certain assets and inventory. The bank was reasonably satisfied with our business development. It was a way for the bank to give us a vote of confidence."

Other bankers mention that they're making more such loans. "We used to make a lot of short-term loans and roll them over all the time—but we were just kidding ourselves," says Embree K. Easterly, president of Capital Bank & Trust of Baton Rouge, La. "If the customer continues to grow, he'll probably never pay it down." Recently Easterly has started making three- to five-year term loans secured by customers' receivables. "In effect, they're capital loans," he says. Banking regulators don't frown on such evergreen loans, he says, if the receivables are turning over and are current.

The competition for small business bucks is also spreading into the chaotic realm of modern electronics. One of the more popular new bank products, requiring just a push-button telephone, allows a small firm to gain better control of its cash balances.

Mellon Bank, for example, calls its version Telecash. It works like this: The firm's financial manager calls a bank computer and asks for the day's checking account balance by pushing a sequence of buttons. After a computerized voice answers, he pushes buttons again to transfer any portion of the sum—even if it's in float—into a money market fund to earn top rates. The next day, if he needs the money, he reverses the process.

(continued on page 44)

Mellon charges 50¢ per transaction, with no minimum or monthly fee.

Only 200 Mellon small business customers are using Telecash so far, yet it's already outmoded. In June, the Bank of New York began test-marketing a system for small businesses that performs the same task without the phone call. When the company's checking-account balance climbs above $6,500, every extra dollar flows automatically into a money market fund. When the balance dips below that, the checking account reaches into the fund and takes back enough to bring it up to snuff.

Bank of New York got the jump on its competitors because it's the country's largest processing agent for money market funds. Thus its computer systems were readily adapted to the new job. So far, it's selling the service, which it calls Checkinvest, to companies with sales between $500,000 and $10 million in Manhattan and Syracuse, N.Y.

Lynn Johnson/Black Star

Barrick: "The bank gave us a vote of confidence."

Unlike Mellon, Bank of New York charges $100 a month for the service. Thus it takes an average bank account balance of at least about $25,000 to come out ahead, depending on money-market payouts. "The average company with $3 million in sales keeps $30,000 to $50,000 in its bank account. Many don't realize it's that high," says a bank spokesman. Assuming money market funds pay 15% a year, a $50,000 balance would net the Checkinvest customer $5,325 a year after maintenance fees.

Many banks are working on their own version of Checkinvest. They take no joy in it, though. Such products threaten to eliminate the pool of cheap small-business money that the banks have only recently come to appreciate. "Some bankers believe that that's encouraging customers to take funds off their balance sheets and put them onto the balance sheet of an investment firm," says Kerry J. Ryan, vice-president and manager of

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TIPS FROM A BANKER

by Michael Celello

Fewer than 10% of prospective borrowers come to a bank adequately prepared. And bankers haven't the time to dig for the facts they need. Unfortunately, the safest thing in banking is to say no. You'll never get fired for that. Want to increase your batting average in the loan office? Here are a few tips.

☐ Pick your bank carefully. Does it deal mostly with larger corporations? Or is it a retail bank, one that aims to serve consumers and smaller businesses? If you pick the wrong one and wind up getting rejected, it will make it that much harder for you to get a loan at a second bank. Banks check credit bureaus, and the bureaus register their inquiries, so the second will know you've been to the well already and come back dry. Nobody likes to be asked second. Bankers are always afraid the first one knew something that they don't.

☐ Have a good accountant prepare a complete set of financial statements for your business, as well as a business plan and a personal balance sheet. If possible have him accompany you to the bank. The banker will have questions, and the accountant can respond to them more objectively.

Most small businessmen are myopic. They don't want to pay accountants. They tend to be aggressive optimists with a marketing or sales orientation, so they don't want to listen to someone they often view as a glorified bookkeeper telling them not to expand too quickly. But an accountant saves the banker a lot of work and shows him that he's dealing with a sharp businessman—one who knows enough to surround himself with expertise. If you come into the bank with an accountant and all the necessary financial information, it improves your odds of getting a loan by 75%.

If you don't go to an accountant, you'll probably settle for a loan with too short a maturity and wind up depleting your working capital. If your business is seasonal, you might fall into a cash-flow bind during slow periods. Then you'll have to return for refinancing, which may mean another round of up-front commitment fees and higher interest rates. You want to shoot for the maximum term you can get while maintaining profitability.

☐ Make an appointment. Many businessmen don't seem to realize that you don't just walk in off the street and ask for $100,000. The businessman who asks for an appointment shows he is business-oriented. You wouldn't make a sales call without first making an appointment—why do it with your banker?

☐ Demonstrate to your banker that you're a person of good character, especially if you're applying for a loan for the first time. A banker likes to know that you're civic-minded and respected in business and community circles. I have seen banks make loans because they know that the borrower is active in the Boy Scouts and goes to church every Sunday.

☐ Show that you don't have your head buried in the sand. A lot of businessmen know their business and their immediate community, but they're often not tuned to what is happening in the world. Pick up the *Wall Street Journal* and read trade journals so that you're knowledgeable about your entire industry and the economy as well as your business. Today, even a business that's been around 100 years can't be too confident.

☐ Be honest with your banker and ask him for the amount of money you really need. If you want to borrow $20,000 so you'll have $5,000 for an electronic cash register, $10,000 for a new delivery truck, and another $5,000 for working capital, that's fine. The bank may want to make three separate loans instead of one, keeping the money for the first two in line with their life expectancies and putting the line of credit in a separate category. Bankers don't like to lend extra money unnecessarily.

☐ Even the best credit prospects must be prepared to personally guarantee their loans. If a businessman isn't willing to put his assets on the line, why should a bank? Whether the business is a sole proprietorship, a partnership, or a corporation, it boils down to a few key people at most. Only giant companies like GE or IBM don't sign personal guarantees.

Michael Celello is president of the People's Commercial Bank in East Greenbush, N.Y.

Mellon Bank's data center division. "But others believe that since it's happening anyway, they'd rather have the customers do it through their bank."

As the easy money dries up for bankers, the profitability of their traditional main activity—taking deposits and making loans—is shrinking. They are looking toward increased direct fees from other services to fill the gap. They'd like financial services for small business to be one of the growth fields.

Adamson: Charging 18½% when the New York prime was 20½%.

Many of these services won't be new. Banks as well as computer service firms have been processing payrolls for companies for three decades, for instance. Other existing computerized services include lockboxes, sales analyses, pension accounting, credit investigations, and accounting packages for receivables, payables, inventory, and general ledger. "All these things have been sitting around—banks just haven't sold them very aggressively to small business," says Roderick.

What will be new is the way many of these become tied together or put "on line." For example, that old standard, the lockbox, metamorphoses into the "automated lockbox."

A lockbox is an arrangement in which a company's customers send their checks directly to its bank. The bank deposits the money speedily in order to take maximum advantage of the float. With the old-fashioned kind, the company doesn't find out how much money came in or when it did until it receives its regular account statement. With an automated lockbox, that information goes immediately into a computer that the company can tap anytime. Money that arrives today can be spent or invested today, electronically.

Cash management services are undergoing swift evolutions of this sort. Mellon's cash concentration service, for example, automatically transfers the balances out of a company's field accounts and into a central one each day. With a recent revision, it now can accommodate a standing order to move the funds only when they reach a specified level. "We probably won't be comfortable six months from now with the system we just rewrote," says Jerry A. Murphy, assistant vice-president for community business services.

There's still a long way to go. "It would be innovative for small companies to utilize the telephone bill-paying system that a lot of banks now offer for consumers," says Mary Pat Cottrell, vice-president for corporate services at Union Trust Co., of Stamford, Conn. "They could use it for business-to-business payments. The system provides a cash disbursement record as well as year-to-date information on expenditures with that particular vendor. The system is there and it's generating enthusiasm on the part of accountants that serve small companies. But a lot of telephone bill-paying systems are very labor-intensive for the bank, so some are very reluctant to solicit use by the small business sector."

One useful service that small businesses can buy now, but haven't, is automatic account reconciliation. This service saves hours or even days reconciling a company's checks at the end of the month. But only 4% of INC. subscribers use it. INC.'s survey also revealed that just 13% of our subscribers use any kind of electronic money transfer at all. That total seems certain to grow as banks sell cash management more aggressively to small business and as firms learn the advantages of managing their money more closely (see page 56).

The emergence in the last few years of inexpensive microcomputers will make on-line electronic banking practical for many small companies that haven't used it before. Microcomputers afford vast flexibility compared to telephone button-pushing.

"Right now, the industry is pushing home banking," comments Murphy of Mellon Bank. "My view is that home banking is never going to be the success that people say it is. It will blossom very quickly, then stagnate. And that's when the multiplying effect will take place in small business. Everybody's going to start being curious about what they can get."

Businessmen are justly suspicious of pie-in-the-sky promises. Whether electronic banking provides a panacea for

(continued on page 50)

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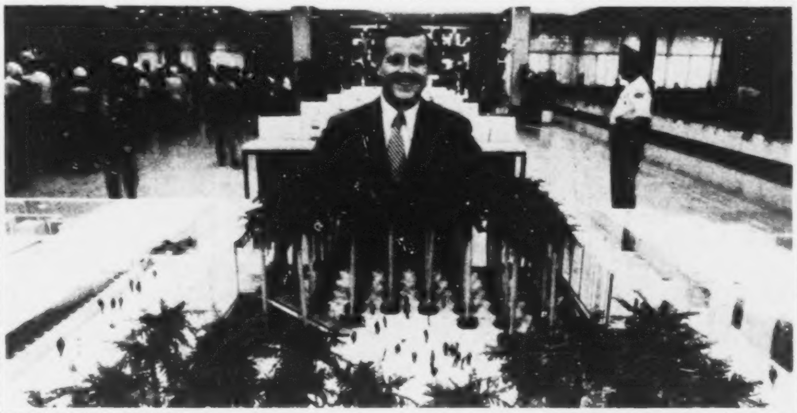

Flip Schulke/Black Star

Wollard: "Banks coming into the middle market keep redefining what it is."

HOW BANKERS VIEW SMALL BUSINESS

(Source: INC. survey of 150 large and regional U.S. banks)

These responses come from bank officers responsible for small business accounts. The questions were "open-ended"—that is, not multiple choice: Respondents gave these answers unaided by suggestions from the interviewer. An independent research firm conducted the interviews by telephone in July and August of 1981. In order to avoid possible pro-small business bias, the interviewees weren't told that INC. had commissioned the study. Totals exceed 100% because the bankers were invited to give more than one response to each question. Omitted are "don't know," "no answer," and items mentioned by fewer than 1% of the respondents.

Question: What were the major reasons for rejecting small business loan applications over the past year?

	% of respondents who mentioned factor
Undercapitalization or too much debt	32%
Lack of collateral	20
Inability to demonstrate source of repayment	15
Poor credit history	15
Inadequate financial information	12
Weak management	8
Applicant lacks experience in his field of business	7
Poor track record or poor profitability	7
Insufficient cash flow	5
Unprofessional financial statements	2

Question: How would you characterize the ideal small business borrower?

Good capitalization, decreasing debt-to-equity ratio, or retains earnings in business	31%
"Good management"	22
Good profit history	21
Good accounting or financial statements	13
Knowledge or experience in this business or product area	11
"Good character"	11
Good credit history	9
Steady growth or growth potential	9
Good cash flow	7
Strong or increasing sales revenue or market share	5
In business a reasonable length of time	5
Good collateral	5
Keeps bank informed	4
Good planning	3
Good product, market, or industry	3
Liquidity	3
Personal equity invested in company	1

Question: What are the major problems in dealing with small business?

Undercapitalization	19%
Inadequate or unreliable records	15
Lack of capable management	15
Inexperience or lack of financial knowledge	11
Inadequate credit rating	5
High interest rates	4
Don't use bank services to full advantage	4
Poor planning or overextension	3
Insufficient profit margins	3
Poor cash flow	3
Unaudited financial statements	2

small business cash woes remains to be seen. But an explosion in the variety of products and services seems on its way. The conscientious manager will make a point of shopping around and trying them.

Indeed, that applies to all aspects of the banking world. With many banks offering small companies better terms than they did before, it may be time to reevaluate one's present bank. Businessmen who haven't visited their bank's competitors for a while might be pleasantly surprised at the reception they're given today.

The big banks plunging anew into this market maintain flexible views on what's "small." While some are devoting increased attention to companies in the $500,000-to-$10-million sales range, most have set their sights on what they call the "middle market," usually defined with an upper limit of $100 million in annual sales. That may sound huge to many INC. readers, but it's peanuts as far as the nation's top 100 or so banks are concerned.

"Banks now coming in after the middle market keep redefining what it is," says Wollard of Southeast First National Bank of Miami. "It used to be $25 million or more in sales; now they're happy to talk to a company with $10 million in sales." Chemical Bank in New York pegs its middle-market minimum at $5 million in sales. Carol J. Parry, Chemical's senior vice-president in charge of Manhattan middle-market companies, says that three-fourths of her customers have less than $20 million in sales.

Small banks, whose traditional small-company market is threatened by the giants, will be fighting back. Though they haven't the same technical power to offer their customers, they do wield one significant weapon against their giant brethren. "We have more stability among lending officers," says A. Andrew Boemi, chairman of Madison Bank and Trust Co. of Chicago. "We don't have the turnover you get at the major banks, which have to shift those young M.B.A.'s around every year for the experience. Small business owners like to be able to come in here and talk to the chief executive officer."

The small business sweepstakes is on. With a host of predators stalking the commercial banks' once exclusive domains, and financial seers predicting the fall of interstate banking prohibitions with increasing frequency, it doesn't seem likely to end soon. "We face a real competitive free-for-all," says Roderick of Robert Morris. "The businessman is going to have a lot more to choose from."

BANKING IN THE '80s

WHEN THE BANK SAYS NO

For this report, INC. surveyed 150 of the largest banks in the country (see table on page 50). Among the questions we asked were: What are the major problems in dealing with small businesses? What were the major reasons for rejecting small business loan applications over the past year? And, what are the characteristics of the ideal small business borrower? No matter how we posed the question, the bankers' message came through loud and clear: Small business has too much debt!

That may sound odd coming from people falling all over each other to lend you money. But high debt-to-equity ratios signal risk, to which bankers are highly averse. "Understand that banks are not really in the risk-taking business," says George S. Arneson, president of Arneson & Co., a Kansas City, Kans., consulting firm. "They're lending someone else's money, and when you look at what they're paying for their money and their administrative costs, their gross margin after bad debts is not that great."

Last year, the National Federation of Independent Business surveyed several thousand NFIB members about their banking relationships, and it made the same discovery as INC. Among the 377 who reported recent loan refusals, the most frequent reason given by the bank was insufficient equity or too much debt.

The solution isn't to get more equity. That would be ideal, but most small businesses stay highly leveraged precisely because they can't find equity. Rather, getting around bankers' reluctance to add to your debt involves a combination of less-than-ideal fixes.

Frequently banks send their rejected loan applicants to a commercial finance company. The bank may even own the finance company, making such referrals a lucrative proposition for it. Occasionally finance companies come through with cash when banks won't. But they demand strong, convincing collateral and charge four or five points over prime to boot. These lenders don't judge you by your chances of growing and prospering; they just count up what your assets would be worth on liquidation.

At banks, collateral fills a different role. A loan officer seeks above all a continuing customer; he'll ask for some collateral just in case he's wrong. Frequently, the pledged assets wouldn't recoup a bank's full investment, anyway.

"No bank that I know of would make a loan secured by a basket full of gold bricks if they really thought they would have to sell the bricks," remarks Richard S. Bibler, executive vice-president of First Wisconsin National Bank of Milwaukee. "No matter how much collateral you pile on the loan officer's desk, he's not going to make the loan if he thinks he'll have to liquidate. Banks aren't pawn shops."

Consultant Arneson cautions against pledging all one's assets for a single loan. "Many companies, when they come in to borrow, haven't planned for enough," he says. "They may ask just for the minimum they want, and most likely it isn't adequate to do the job to begin with. If you don't borrow enough the first time, you almost always have trouble getting your next loan, because all your assets are tied up and you haven't any-

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DO BANKERS DO THEIR JOB WELL?

Small business isn't just like big business except smaller. It's fundamentally different. For one thing, small business uses more debt. According to Federal Trade Commission statistics, the average small manufacturing corporation with assets under $5 million showed a debt-to-equity ratio of 1.23 in 1978, while all companies, on average, had a ratio of 0.93. Or, for every $1 in equity, small manufacturing companies carry at least 30¢ more debt than large ones. The figures for service companies are similar.

Are bankers wrong to hold smaller businesses to the same capitalization standards that they set for big business? Do they fail to look beyond debt-to-equity ratios for the real strengths of a business? Should they be willing to take more of a chance on small enterprises? Some consultants think bankers don't do their jobs very well when it comes to small business.

It's canon in the banking profession that a loan officer's personal opinion of his customer plays a crucial role in lending. In INC.'s survey of 150 large banks, respondents frequently mentioned management character, integrity, and experience as important qualities in a loan applicant. But evaluating a small company's management takes lots of a banker's time and energy, compared to the return he may foresee. "For most bankers, the measure of how good you are as a manager is how you stack up against industry ratios," says Sharon F. Poindexter, a Wichita, Kans., consultant who runs small business financing seminars for the National Association of Bank Women. "And the performance of many small businesses will not fall into the positive range of acceptance if you're looking only at industry ratios."

William Armbruster

Poindexter: "It's not the amount of money that makes or breaks a business."

Poindexter urges applicants who have been rejected for a loan because of undercapitalization to pursue the banker with more questions. "Have the banker clarify what he means by undercapitalized," she says. "It's not the amount of money that makes or breaks a business. I've seen lots of businesses that had lots of money and still went under. It's a matter of managing the capital that's available. Sometimes it's a matter of restructuring how you're going into the marketplace." Exchanging these sorts of ideas with a banker, she counsels, builds a relationship that may clinch the loan.

"The average borrower doesn't know the basis that the banker uses for his decision," says Edward H. Pendergast, president of Financial Management and Consulting Corp. in Boston. "And I don't think the

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thing left to pledge."

For companies with truly insufficient equity to please loan officers, the mission becomes cajoling more use out of the existing capital base. One crucial variable is net working capital (current assets minus current liabilities). That's the amount of equity used to finance day-to-day operations, the rest being tied up in long-term assets such as plant and equipment. Successfully juggling inventory, receivables, cash, and payables can create a sizable chunk of net working capital where little was before. That could warm the heart of a lending officer, who's probably been inculcated with the principle that net working capital should be about equal to current liabilities.

Bernie J. Grablowsky, a professor of finance at Old Dominion University in Norfolk, Va., surveyed Norfolk small businesses with up to $5 million in annual sales and found that they kept an average of $30,000 sitting in the bank all year for each $1 million in sales. If money markets are paying 15%, then that sum could be earning $4,500 a year in interest. Put to work financing current operations—such as by buying more inventory and paying for additional labor—it might earn several times that much.

And that was only the money that these business people knew they had. Often entrepreneurs don't really know how much cash they have available. The float on checks sent out and on deposits made leaves a fuzzy area around most business checking account balances.

Perhaps some of these cash balances were fulfilling compensating balance requirements on loans, but probably not many. For example, finance professor Philip L. Cooley of the University of South Carolina, along with Richard J. Pullen of Canada's Confederation College, surveyed 180 companies across the United States who market petroleum products. They found that among those with less than $1 million in assets, only one in five was required to keep compensating balances. For those with over $1 million in assets, the proportion was about one in four. These figures probably resemble those of small companies in other industries.

Another solution to the cash crunch, which many businesses rely on heavily but perhaps don't appreciate enough may be to "borrow" from suppliers.

There are some creative ways to do that. Stephen J. Gurgovits, executive vice-president of the First National Bank of Mercer County in Sharon, Pa., writes letters of credit for some of his customers. That's a contract, used widely in international trade, guaranteeing the suppliers payment in case the buyer of the goods defaults. Gurgovits says that some suppliers offer their customers better terms on advances than the bank could give. "We look at it this way," he explains. "It gets a better deal for your customer, and

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Hank Young/Black Star

Arneson: "Banks are not really in the risk-taking business."

banker always tells him. Don't be ready to take no for an answer. Ask why you were rejected."

Arthur F. F. Snyder, president of Boston's Commonwealth Bank & Trust Co., puts it more bluntly: "I have to admit that many bankers are chicken. They are afraid of being candid. They don't come out and say, 'Fella, I don't like this.' They say, 'What you need is more capital,' when they didn't like something else that you will never know about."

California's former deputy superintendent of banks, Derek Hansen, thinks he knows why bankers emphasize debt-to-equity ratios so strongly. In theory, a lender can take slightly higher risks if he charges a slightly higher rate for the loan. In a given portfolio of loans, the return from the vast majority of successful risks offsets the occasional bad loan. In practice, says Hansen, banks don't think like that. They don't because banking regulators don't let them.

When regulators spot an above-average loss rate—three-tenths of 1% of a total portfolio is typical, and twice that is considered dangerous—they impose strict remedial measures, such as requiring the bank to raise additional capital. They don't ask whether the bank earns enough on its good loans to compensate for the losses. As a result, "Banks don't have the ability to lend on a risk-reward curve," Hansen says. "The system doesn't have anywhere in it a lender who can take even moderate degrees of risk—such as a 1%, 2%, or 3% loss rate instead of three-tenths of 1%.

"A classic example is a bank we had in California a few years ago that was doing very well, but showing a high loss rate," says Hansen. "They charged enough on their loans to cover that risk, so their bottom line was better than other banks. But the banking system regulatory authorities couldn't deal with that—they were classifying almost all of those loans.

"This conservative bias favors consumers whose borrowing needs are generally less risky than businesses, whose loans can often be collateralized with automobiles or other assets," says Hansen. "It favors real estate, which is in itself a form of insured security. It favors large businesses that can often provide security from mature, profitable company operations and assets to secure borrowed capital to cover newer, more risky ventures. It does not favor entrepreneurship."

WHY YOU NEED DEBT TO GROW

Managers of small companies sometimes wonder why a successful company with an unbroken record of profits is short of cash. But, in fact, growth in sales increases the need for financing. A small company with, say, $100,000 in assets ($60,000 in current assets and $40,000 in fixed assets) that is financed by $30,000 current liabilities and $70,000 of owner's equity usually needs more assets to expand its operations and, through such expansion, increase its sales.

Let's assume that this company wants to double its sales. To support that increase, let's further assume that assets have to be increased to $150,000. If current liabilities could be expanded by $20,000 then $30,000 must be found. The two main sources for this $30,000 are reinvested earnings and debt. If the income realized by the firm after taxes is $10,000, and the owner decides to reinvest it completely, there is still a need for $20,000.

From "14 Financial Pitfalls For Small Businesses," by Moustafa H. Abdelsamad, Guy J. DeGenaro and D. Robley Wood, Jr., in *S.A.M. Advanced Management Journal*, Spring, 1977.

FIRST NATIONAL

Tom Barr/Black Star

Gurgovits: "We've eliminated annual cleanup across the board."

they pay us a fee for the letter of credit."

A letter of credit costs a fraction of a loan in the same amount because the bank commits none of its funds to the transaction—assuming, of course, the customer doesn't default. The fee is an insurance premium; the bank acts exclusively as insurer.

There's a good reason why suppliers frequently offer their customers much more generous terms than a banker would. For example, suppose a supplier sells $10,000 worth of goods to a customer monthly on 30-day terms. In a year, he sells $120,000 worth of merchandise to him. If the customer ordinarily pays in 30 days, the supplier regularly keeps $10,000 at risk in outstanding receivables to his buyer. If the supplier makes a 10% before-tax profit on his sales, then he earns $12,000 a year on the continuing $10,000 invested in the receivable.

That's a 120% return on his investment. If a bank, on the other hand, were to lend the customer $10,000 to finance the payables for 30 days over the course of a year, it could earn only, say, 15% to 20%, or $1,500 to $2,000, on the same investment.

This supplier is a good candidate to approach for longer terms. Extending them to 60 days would still earn him 60% of his investment. Why should he cut his return in half? He might be very amenable to giving a good customer some leeway during trying times.

Supplier credit, in fact, is a bigger source of debt capital to small manufacturing firms than bank loans. According to the Federal Trade Commission, small business trade accounts and notes payable added up to 17.2% of their total assets in 1978, while bank loans of all kinds accounted for 16.5%.

By borrowing money when cash could be squeezed out of current operations, a small business pays twice: Once to the banker, and once by losing the opportunity to use idle dollars in the business. Plenty of small business managers recognize that they could manage working capital better; they just don't have the time, they say. The typical financial officer of a small company has his hands full just maintaining the books, placating the creditors at the door, and keeping the company solvent.

But many entrepreneurs need to take time out to brush up their financial knowledge. With plain old cash worth as much as 20% a year, all the old textbook techniques of managing receivables, payables, cash, and inventory are worth two to three times more than just a few years ago. Some who seek money from banks could find it instead in their own backyards. Many have no choice. ☐

Doran Howitt is an associate editor at INC.

HOW GOOD A CASH MANAGER ARE YOU?

One banker says that the principles of cash management are easy: "Collect fast, pay slow, and invest in the meantime." But sometimes it's just the opposite. Do you know when? For an indication of how good a cash manager you are, try this test:

You buy merchandise on standard terms of 2/10 net/30 (a 2% discount for payment within 10 days, or the full amount due in 30 days). Before reading the next paragraph, choose from among the following possible answers the approximate cost, on an *annual* basis, of passing up the discount and paying in 30 days instead: a) 2% b) 8% c) 20% d) 24% e) 36% f) 72%.

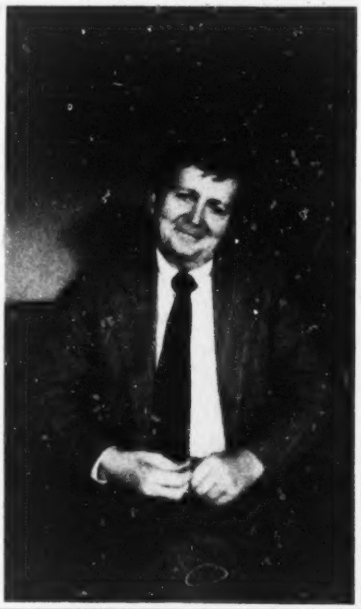
To find the correct answer, first assume you earn a 2% return on a 20-day investment—that is, giving up your cash 20 days early. Then multiply by the eighteen 20-day periods in a year (assuming a 360-day year). It comes out to 36%. Unless you can earn more than that on your money, you should *always* take your cash discounts. Even if you have to borrow at 20% interest in order to do so, you come out ahead.

WHERE ARE YOUR RECEIVABLES RIGHT NOW?

Does your company have to write off some receivables as bad debts? If so, did you let a collection agency try its hand? Many small business managers are reluctant to hire collection agents. An agency's commissions often run as high as 50% of what they bring in, which sounds exorbitant. Managers figure that by "sitting" on the debts, they might eventually collect all.

That attitude is unwise. An illustration shows just how worthwhile a collection agent's efforts can be. Assume a firm is in the 46% tax bracket, and that the collection agent charges a 50% commission. The firm *loses* $54 after taxes on every $100 written off, whereas it *gains* $50 after taxes for every $100 the collector retrieves. That's a profit differential of $104 for every $100 the agent collects. At lower tax rates the differential widens.

Observes Edward H. Pendergast, president of Financial Management and Consulting Corp. in Boston: "A lot of good-sized companies don't manage their receivables properly because they don't get around to following up on them until after they've sent 3 letters. Any good cash manager who needs cash is going to ignore the first 12 letters."



Marjorie Nichols

Pendergast: "Don't be ready to take no for an answer."

MILTON D. STEWART: THE BUCK STOPS HERE

"TO SECURE THESE RIGHTS..."

This is the first of a series of articles that will appear from time to time in this space on the general subject of "The Federal Turnaround We Need." In them, we'll review some of the issues underlying federal policies on a wide range of subjects: taxes, capital, credit, government competition, data collection, mergers, technology and patent policy (see National Affairs, page 35), and procurement, among others.

There are several reasons for this series:

First, the cumulative impact of federal policies—and lack of policies—has made our national government a dangerously strong force for domestic economic concentration. It needs to be turned into a force for economic diversity.

Second, this trend in government policy has come about, in part, because of a failure of small business advocates to make their case as clearly as possible, and to show that it's in the national interest to promote the welfare of small business.

Third, small business has fallen prey to the illusion that it must ignore government because it can't influence what government does, and that economic policies that seem good for all business will automatically take care of small business's needs.

Fourth, the leaders of America's large companies have not yet read the clearest lesson of modern Western Europe's economic history: The shrinkage of the small business sector is generally (from my reading, invariably) followed by strong moves toward the governmentalization of the remaining large-business sector. "What's good for small business is good for all business" has turned out to be a truer maxim than "What's good for all business is good for small business."

Fifth, the self-righting process of the American government's system of checks and balances still isn't working well enough for small business. Neither liberals nor conservatives, Republicans nor Democrats, have yet been made responsive to the needs of small business. Neither the Congress nor the courts, nor, least of all, the executive branch, has moved to arrest the swing of federal policy away from small business and toward both government and government-sized business. All the branches of our government, and both political parties, have been content to deal with national policy as a choice between public bureaucracy and corporate bureaucracy. But there are essential national goals that can best be met by a larger independent, entrepreneurial small business sector.

The best place to see what these goals are, and to understand the issue between small business and government, is right at the beginning of our country. Let's start with these words:

> We hold these truths to be self-evident, that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty, and the pursuit of Happiness. That to secure these rights, Governments are instituted among Men, deriving their just powers from the consent of the governed.

Among the many personal rights that I want to preserve and expand for myself, my children, and my grandchildren are two that are particularly relevant to the survival of independent small business.

The first is simply the right to start, own, manage, and make my living from my own business if I want to do so.

The second is the right to live in the most diverse economy possible, with the largest possible number of employers, and the widest possible range of owners and jobs.

These two rights, if I have them, go far toward strengthening my ability to enjoy many other rights. They give me a feeling of

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THE BUCK STOPS HERE *(from page 180)*

personal independence, a sense of having real freedom. If these rights are maintained, I know that whether I work for a big business, a big government agency, a big university, a big union or charitable institution, or a small company owned by someone else, I can always quit and do something else. The larger the number of employing units, the greater my freedom will probably be. (I say "probably" only because there are other things to take into account, such as the possibility that there will be too many people competing for too few jobs.)

The two rights I have just stated have been pretty much taken for granted throughout our history. Yet I have not found a statement of them as rights that has been given the dignity of express legal protection by either the Constitution or the laws of the federal government and the states. Nor is there any theory I know of that finds them clearly and necessarily implied by any other legally protected and acknowledged right. If any lawyers or other readers can enlighten me further, I'd be delighted.

The larger the share of the economy that is not divided between government and government-sized business, the more meaningful both of these rights will be. The more prosperous, profitable, and numerous private small and medium-sized businesses are, the more people there will be for whom the sense of freedom is real. The more room there is in the economy for new businesses to start and succeed, the less we will need to worry that economic concentration will lead to the loss of personal liberties.

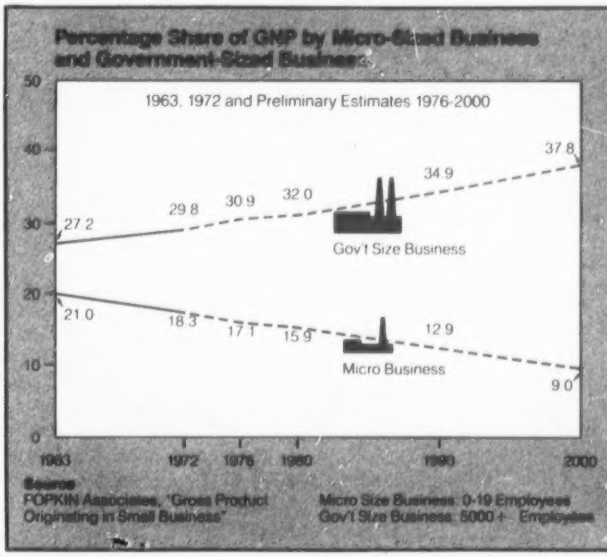
At the federal level, there seems to be more and more dangerous insensitivity to these rights both in the career bureaucracy and among political appointees. As federal preoccupation with foreign policy, defense, and the world economy increases, less and less attention is being paid to the impact of federal actions on the small business sector. During the Carter Administration, only the vigilance of a congressional committee and small business advocates in the private sector prevented a proposed foreign trade agreement from stripping domestic small business of important federal procurement rights. The most shocking thing about the incident was that those concerned with making the policy were not even aware that they should have been thinking about its effect on small business.

> The larger the number of employing units, the greater my freedom will probably be.

The current administration has been urged to oppose the bill I have discussed here several times—S. 881, which is sponsored by Sen. Warren Rudman (R-N.H.) and 81 other senators, and which requires certain federal agencies that finance nationally needed research and development in the private sector to spend minimal amounts with small business. Every opposition argument is specious or conjectural in the extreme. At bottom, the bureaucracy is saying that it has a "right" to spend this money exactly as it damn well pleases, and that this "right" of theirs is more important than the most minimal assurance that there will be some effort to encourage diversity in technology.

The case for small business—and for federal policies more favorable to it—does not rest on my assertion of theoretical personal rights alone. It rests also on "hard" arguments like the importance of technological innovation, of strengthening competition, of creating jobs, improving the balance of payments, and expanding the size and diversity of our industrial base for defense protection.

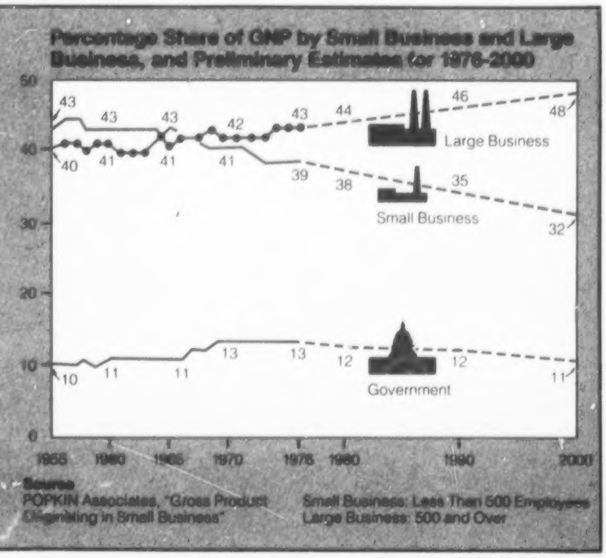
In future issues, we'll take some of these arguments and try to define further the two rights I've outlined. In December, Robert Berney will deal in our Economic Issues department with the problem of the federal government's data collection and reporting on small business. In that same issue, I'll discuss further in this space the problem of holding elected and appointed officials accountable for securing these two rights. We should ask of every federal program that affects small business, "Will it help to secure or will it weaken these rights?" We need our government to acknowledge its obligation to small business—not to guarantee that everyone who tries to run a small company will succeed, but to see to it that its economic policies give as many of us as possible the opportunity to try. □



Percentage Share of GNP by Micro-Sized Business and Government-Sized Business

Source
POPKIN Associates, "Gross Product Originating in Small Business"

Micro Size Business: 0-19 Employees
Gov't Size Business: 5000+ Employees



Percentage Share of GNP by Small Business and Large Business, and Preliminary Estimates for 1976-2000

Source
POPKIN Associates, "Gross Product Originating in Small Business"

Small Business: Less Than 500 Employees
Large Business: 500 and Over

Geoffrey Hodgkinson

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Photos by Andy Levin/Black Star

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Cover letterforms
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DAVIDSON IRON WORKS
DAVIDSON IRON WORKS
Merry Christmas from all of us at Jack Daniel's

Jack Daniel Distillery, Lem Motlow, Prop., Inc.,
Route 1, Lynchburg (Pop. 361), Tennessee 37352

The INC. Private

One hundred of the fastest growing privately held companies in the United States.

In the fall of 1971, Bill Nicolai was camping in Washington State's North Cascade mountains when his tent collapsed and he almost froze to death. That winter, Nicolai designed the Omnipotent – a highly durable waterproof tent that became the first product of Early Winters, a Seattle retail and mail-order business whose sales will easily top $8 million this year.

About the same time that Nicolai was coming to grips with the perils of backpacking, Jeff Stoops was taking his first step into the trucking business. With his father as a silent partner he purchased a tractor in 1971. The 10-wheel rig became the first vehicle in an Indiana-based transcon-

By Bradford W. Ketcham, Jr.

The INC. Private 100.

A cotton module built with Cotton Machinery Co. equipment dwarfs Jeff Johnson.

Andrée Abecassis

tinental fleet with more than $15 million in revenues this year.

While Nicolai and Stoops were preoccupied with tents and trucks, Stanford B-School graduate Chuck Schwab launched his own brokerage firm. From a small, no-frills office in San Francisco's financial district in 1971, Charles Schwab & Co. has ticker-taped its way to $46 million in revenues this year, with 180,000 clients served by 31 offices coast-to-coast.

Nicolai, Stoops, and Schwab are all chief executives of companies that qualified as charter members of the INC. Private 100.

Statistically, the INC. Private 100 is a precedent-setting roster of 100 of the fastest-growing privately held smaller businesses in the United States. This list represents an elite club whose members have generated sales gains ranging from 972% to 9,372% over the past five years. (Six of these companies are profiled briefly beginning on page 46.)

The INC. Private 100 share a number of characteristics besides meteoric growth. The median sales of the group in 1980 was $5.9 million; 85 of the 100 companies were founded after 1970; and 98 boast black ink on their bottom lines. In addition, 73 of the 100 are service companies, and only 22 have grown through acquisition. These last two characteristics—service and internal growth—are in sharp contrast to their publicly owned cousins on the INC. 100 (May 1981), the majority of whom are manufacturers whose growth during the past five years was assisted by acquisitions.

Ownership aside, the primary differences between the INC. Private 100 and the INC. 100 are size, growth rate, and diversity. The closely held firms tend to be much smaller. Overall, they are about one-fifth the size of the fastest-growing public companies. Some 70 of the Private 100 firms are still below the $10-million mark in volume, versus 23 among the INC. 100. Only 7 of the private firms, as opposed to 55 of the public companies, have surpassed $25 million in annual sales.

The private companies also outpace the public ones in overall performance. From 1976 through 1980, sales of the Private 100 soared by 1,974%, resulting in a compound average annual growth rate of 113%, better than the INC. 100's compound annual rate of 89% and an outstanding achievement when measured against the 14% eked out by the country's 500 largest corporations.

The Private 100 are far more diverse than the publicly held companies, both in types of business and in geographic location. While the public companies represent a wide range of manufacturing and service businesses, the majority fall within three major industry clusters: computer and business-equipment makers, oil-and-gas producers, and manufacturers of medical products. And although there are INC. 100 companies in 25 states, the majority have headquarters in California, New York, Colorado, Texas, or Minnesota.

Not surprisingly, the largest segment of manufacturers in the Private 100, six firms, are in the computer field. Beyond that, the roster includes companies that make products ranging from Easter-egg kits and pet-food flavors to road-repair machinery and ammunition systems for the Air Force.

The 73 service companies on the list are even more diverse. The two largest groups consist of seven software/data

TOP 20 PERFORMERS IN SALES PER EMPLOYEE

Using 1980 sales per employee as a measure of productivity, here are the top 10 producers in two industry categories.

Manufacturing

Rank	Company (Private 100 rank)	Sales per employee
1.	Sterling Oil & Chemical (93)	$6,662,000
2.	Vital Signs (33)	291,667
3.	Decor (81)	172,000
4.	Morgan Mfg. (61)	166,667
5.	Precision Rolled Products (11)	142,219
6.	Crafco (28)	118,520
7.	Astro Wire & Cable (52)	113,733
8.	Numeridex (25)	105,185
9.	North Star Computers (2)	103,333
10.	Reactive Metals & Alloys (99)	103,255

Service

Rank	Company (Private 100 rank)	Sales per employee
1.	John Galt (78)	$1,063,273
2.	Trend Goup (41)	614,222
3.	New England Rare Coin Galleries (74)	576,435
4.	W-B Pump & Supply (49)	388,938
5.	Country Stove and Shelter (34)	256,222
6.	Associated Druggists (48)	249,318
7.	F.J. Sciame Construction (14)	245,886
8.	Furniture Consultants (24)	233,778
9.	Crum Electric Supply (21)	199,208
10.	Alfred S. Buyer (47)	181,550

INC. PRIVATE 100 PROFILE

The composite statistics of the 100 privately held small businesses offer a new measure of fast growth. The group's sales soared from $53.8 million in 1976 to $1.1 billion in 1980, at a compound annual rate of 113%. At the same time, employment skyrocketed by more than 30,000 jobs. Three out of 4 have grown internally and all but 2 are profitable.

No. of firms by industry	
Manufacturing	27
Services	73
Total sales in 1980 ($ millions)	1,115
Percent change (1976-80)	+1,974
Percent change (1979-80)	+79.4
Median sales in 1980 ($ millions)	5.9
Median sales in 1976 ($ millions)	0.3
Comp. average annual sales growth (1976-80)	
Total (%)	113.4
Range (%)	81-212
Median (%)	98
No. operating at a profit	98
No. acquiring other firms (1976-80)	22
No. founded since 1971	85
Average age (years)	8.2
Total no. of employees	
1980	32,684
1976	2,332
Percent change in employment (1976-80)	+1,302

INC. Private 100 letterforms by Tim Girvin

One hundred of the fastest growing

Rick Ansay (left) and Harold "Hap" Landis of American Awning & Patio Co.

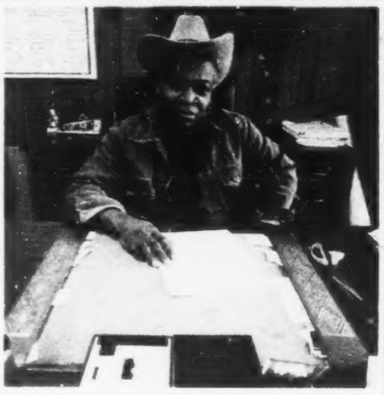
Bruce McAllister/Gamma Liaison

processing businesses and seven high-tech engineering support firms. Beyond those, the list includes a handful of personnel specialists, four restaurant chains, and three publishers.

The five wholesalers in the Private 100 are companies that sell electrical supplies in Wyoming, furniture in Washington, drugs in Kansas, wood stoves in Connecticut, and wine in Arizona. Overall, the Private 100 are headquartered in 36 states and the District of Columbia; California, Texas, Illinois, Massachusetts, and North Carolina are the leading home states.

While the statistics reflect the explosive growth and diverse nature of the INC. Private 100, the true significance of this elite group is the human element. Behind each entity is an entrepreneur whose ingenuity and perseverance has led to outstanding growth. That growth must be measured in terms of people as well as sales.

In 1976, the Private 100 employed a total work force of slightly more than 2,300 people. Five years later, that work force had grown by more than 30,000 jobs, at a compound annual growth rate of 93%. As job generators, the fastest-growing smaller companies are far ahead of their giant corporate counterparts. In the same five-year base period, for example, the nation's 500 largest corporations hiked their employment by 7%, a compound growth rate of only 1.8%.



Herman Gilbert of Apollo Bedding Co.

Tom Simon/Gamma Liaison

Will the Private 100's spectacular growth continue? Where will these emerging enterprises go from here? Some will undoubtedly succumb to merger mania, cashing in their chips as a result of offers that they can't refuse. A few others, eager for capital and liquidity, will relinquish their closely held ownership and cross the threshold into the public market. And one or two will end up in the casualty column, victims of quiet liquidation and/or noisy creditors.

INC. PRIVATE 100/INDEX

Company (Rank)	State
A-America (3)	Wash.
Acsis (89)	N.Y.
Ad-Tek Engineering Services (71)	Calif.
Advanced Technology (32)	Va.
American Awning and Patio (94)	Colo.
Apollo Bedding (79)	Ohio
Associated Druggists (48)	Kans.
Astro Wire & Cable (52)	Mass.
Atlas Energy Systems (80)	Calif.
Austin-Nelson Construction (39)	Tex.
Ava Care (83)	Tex.
Brock International Security (95)	Vt.
Buyer, Alfred S. (47)	Mass.
Career Blazers Personnel Services (73)	N.Y.
Centec (86)	Va.
Century Data Systems (84)	N.C.
Coastal Compression Service (70)	La.
Coloney, Wayne H. (12)	Fla.
Columbia Data Products (13)	Md.
Computer Store (29)	Mass.
Cotton Machinery (31)	Calif.
Country Stove and Shelter (34)	Conn.
Crafco (28)	Ariz
Cromemco (7)	Calif.
Crum Electric Supply (21)	Wyo.
DHL (43)	Calif.
Dallas-Ft. Worth Distributing (88)	Tex.
Data Electronics (56)	Calif.
Data Translation (58)	Mass.
Decor (81)	Ala.
Denver Spectrum (76)	Colo.
Design 1 (54)	Calif.
Diamond Enterprises (53)	Utah
Digital Systems House (36)	Ill.
Double "L" Mfg. (77)	Ida.
Early Winters (38)	Wash.
Elcan Investments (59)	Ala.
Food Specialist (27)	Calif.
Furniture Consultants (24)	N.Y.
Galt, John (78)	Md.
Godfather Investments (18)	Nebr.
Golden Corral Restaurants (10)	N.C.
Industrial Fabricators (68)	Tenn.
Input (97)	Calif.
Jacoby & Meyers (23)	Calif.
K&B Engineering (20)	Calif.
K.S. Inc. (90)	Minn.
Kassouf Parking (30)	Ohio
Kirke-Van Orsdel (8)	Iowa
Knight Equipment (50)	Calif.
Le Beacon Pressé (19)	Wash.
Levy Security Consultants, B.W. (98)	Ill.
Los Alamos Technical Associates (40)	N. Mex.
M & M Products (22)	Ga.
McCormack & Dodge (72)	Mass.
Medevac (87)	Calif.
Microcomputer Systems (35)	Calif.
Microtech Mfg. (55)	Minn.
Morgan Mfg. (61)	Ill.
Navidyne (37)	Va.
New England Rare Coin Galleries (74)	Mass.
North Star Computers (2)	Calif.
Numanco (45)	R.I.
Numeridex (25)	Ill.
PBM Office Products (46)	Ohio
PTC (9)	Pa.
Parker Construction (17)	S.C.
Phone Directories (100)	Utah
Polk Audio (69)	Md.
Potomac House (26)	W. Va.
Precision Rolled Products (11)	Nev.
Progressive Graphics (82)	Ill.
Quorum Clubs of Texas (44)	Tex.
Raven Systems & Research (96)	D.C.
Reactive Metals & Alloys (99)	Pa.
Research, Analysis & Management (51)	Md.
SAS Institute (15)	N.C.
Saddlebrook (57)	Mass.
Schwab, Charles (92)	Calif.
Sciame Contruction, F.J. (14)	N.Y.
Selective Personnel (91)	N.J.
Service Industries of America (85)	Ariz
Sterling Oil & Chemical (93)	Mich.
Stoops Express (1)	Ind.
Sun Hill Industries (67)	Conn.
TSR Hobbies (6)	Wisc.
Techexport (75)	Mass.
Technology for Energy (4)	Tenn.
Telecommunications Specialists (60)	Tex.
Trend Group (41)	Pa.
Tudor Systems (42)	N.C.
Vector Group (16)	Va.
Vintage Selections (64)	Ariz
Vital Signs (33)	N.J.
W-B Pump & Supply (49)	Tex.
Western Control Equipment (62)	Calif.
Willis Companies (5)	Tex.
Windamatic Systems (65)	Ind.
Wolcott Associates, John (66)	Calif.
Wren Associates (63)	N.J.

HOW THE INC. PRIVATE 100 WERE SELECTED

Identifying 100 of the fastest-growing privately owned companies in the United States was a massive editorial project. Modeled on the annual INC. 100 ranking of publicly held corporations, the project, launched last spring, began with the establishment of four criteria.

To be included in the Private 100, each company had to meet the following qualifications:

1. The company is an independent, privately held corporation, proprietorship, or partnership. All businesses were eligible, with the exception of banks and trust companies.

2. The company had to show an operating history of at least five years, spanning the base period 1976-80. (The final ranking is based on the percentage increase in sales between 1976 and 1980). Companies founded after 1976 were excluded.

3. The company had to have sales in 1976 of at least $100,000, but less than $25 million.

4. The company's 1980 sales had to exceed its 1979 sales. Companies showing spectacular growth in the five-year period, but a sales decline in 1980, were excluded.

While the criteria were relatively simple, the task of identifying the 100 finalists was complex, both because of the large numbers of companies involved, and because the project relied on voluntary data generally accepted as strictly confidential.

Various estimates suggest that the number of closely held enterprises that make up the universe of potential Private 100 firms range from 100,000 to more than 4 million. Latest Internal Revenue Service figures, for example, show that 3.9 million corporations and partnerships filed tax returns in 1980. Relying on U.S. Enterprise Statistics, INC. estimates that the total universe consisted of some 205,400 companies—the number of U.S. firms whose sales exceed $1 million. The growth rates achieved in the five-year base period meant that no company whose sales were less than $1 million in 1980 could qualify for the final listing.

Having gained an appreciation of the magnitude of the small business universe, INC. proceeded with its research by relying on two basic sources: its readers and existing in-house records. In addition, business groups, trade associations, and major professional service firms were alerted to the search for small high-growth companies by letter, print advertisements, and personal contact.

Business reply cards were inserted in INC.'s June and July 1981 issues inviting readers to nominate candidates for the Private 100. Drawing on the publication's national circulation of more than 400,000, the cards generated more than 3,000 entries between June 1 and August 31, the specified deadline.

During the same period, an existing in-house data base originally compiled in conjunction with the 1980 INC. 100 was screened to produce an additional 14,000 candidates. Another 500 names were added from reports, directories, and editorial files. On August 1, data forms were sent to 14,500 chief executives. A second mailing, directed to the candidates submitted by readers, followed one month later. More than 2,500 responses were received from a total mailing of 17,500.

From those responses, 500 smaller privately owned companies whose sales had more than tripled in the past five years were identified and ranked by percentage gain in sales. Information on the top 100 was then verified through signed statements from company officers, support material from outside professionals, and telephone interviews.

INC. makes no claim that its final charter list is a definitive ranking of *the* 100 fastest-growing private companies in the country. Clearly, one of the reasons for remaining closely held is to avoid having to reveal financial information. But the Private 100 roster, the only one of its kind, does offer a measure of the scope and performance of the country's closely held smaller businesses.

Most of the companies, however, will continue to thrive. They didn't set out to rack up record growth; it became the gratifying byproduct of their ingenuity and perseverance.

Bill Nicolai, Jeff Stoops, and Chuck Schwab can attest to that. Excited by new developments in fabrics and design, Nicolai intends to continue creating tents, rainwear, and other outdoor gear that promise to accelerate his retail and mail-order business.

Jeff Stoops was recently stopped in his tracks by an attractive offer for his company that would have enabled him to retire at age 34. He admits that he considered the deal for a few days, seriously weighing the future of long-haul trucking in light of deregulation, escalating fuel costs, and the proliferation of the railroads' piggybacks. "But," he says, "the truth is I have a lot of fun running this company. I've got a lot of young people here, and they keep the business exciting. It may be corny, but I'm having too much fun to quit."

Chuck Schwab pegs himself as "the Freddie Laker of the brokerage world" and envisions a $200-million operation down the road. He is confident that in the year ahead his firm will handle more than $2 billion worth of security transactions. While he dabbles in the market himself, Schwab is also quick to point out that his only real investment right now is his company. "I've got only one egg in my basket," he says, "and I watch that basket very, very closely!"

It's a safe bet that among the INC. Private 100 there are at least 99 other owner-managers who are doing exactly the same thing. ☐

Editor's note: The information published in this report is based on material supplied by the companies. In each case it has been verified in writing by a company officer, by supporting financial statements, and by telephone interviews between INC. *editors and company principals. The published information is the only material that* INC. *will make available. Under no circumstances will* INC. *release the names of company officers, addresses, or telephone numbers. Furthermore, unpublished proprietary information gathered during the course of the research will remain strictly confidential. This policy applies to the 100 companies listed as well as to those companies that submitted information as candidates for the ranking but failed to qualify.*

Bradford W. Ketchum, Jr., is a senior editor at INC.

The INC. Private 100

Company (by rank)	Sales Growth 1976-80		'80 Sales ($000)	'76 Sales ($000)	Profit range*		No. of employees		Acquisitions '76-'80	Date founded	Business description
	Percent increase	Compound annual rate			'80	'76	'80	'76			
1. **Stoops Express** (Daleville, IN)	9,372%	212%	$10,641	$ 112	C	C	152	18	No	1976	ICC regulated motor carrier
2. **North Star Computers** (San Leandro, CA)	7,650	197	15,500	200	B	B	150	2	No	1976	Mfr. microcomputers
3. **A-America** (Seattle)	6,876	189	7,779	112	C	C	56	4	No	1974	Importer/wholesaler furniture, gifts
4. **Technology for Energy (TEC)** (Knoxville)	6,249	182	9,310	147	C	A	128	2	No	1975	High-tech services to utilities
5. **Willis Companies** (Houston)	5,908	178	9,791	163	C	D	108	5	No	1976	Personnel services, clerical & medical
6. **TSR Hobbies** (Lake Geneva, WI)	5,233	170	16,000	300	B	B	120	12	No	1975	Publisher of games
7. **Cromemco** (Mountain View, CA)	5,067	168	31,000	600	B	C	600	17	No	1975	Mfr. microcomputers
8. **Kirke-Van Orsdel** (Des Moines)	4,529	161	6,527	141	B	D	220	23	Yes	1974	Insurance broker-administrator
9. **PTC** (Bensalem, PA)	4,264	157	14,965	343	C	C	184	21	No	1974	Telecommunications systems sales/service
10. **Golden Corral Restaurants** (Raleigh, NC)	3,929	152	81,245	2,017	B	B	5,300	200	No	1973	Family steak house restaurants
11. **Precision Rolled Products** (Reno)	3,870	151	20,764	523	B	C	146	10	No	1974	Mfr. specialty metal bars
12. **Wayne H. Coloney** (Tallahassee)	3,777	150	18,526	478	C	D	300	32	No	1970	Mfr. machine systems
13. **Columbia Data Products** (Columbia, MD)	3,704	148	4,032	106	B	B	90	5	No	1975	Mfr. computers & peripherals
14. **F.J. Sciame Construction** (New York)	3,575	146	8,606	234	C	C	35	4	No	1975	General contractor
15. **SAS Institute** (Cary, NC)	3,397	143	4,864	139	B	B	70	5	No	1976	Computer software
16. **Vector Group** (Alexandria, VA)	3,284	141	4,135	122	C	C	75	12	No	1975	Data processing/communications consulting
17. **Parker Construction** (Charleston, SC)	3,200	140	3,300	100	A	A	40	4	No	1975	General contractor
18. **Godfather Investments** (Omaha)	3,133	138	194,000	6,000	A	A	14,000	433	No	1973	Franchisor/owner Godfather's Pizza restaurants (580)
19. **Le Beacon Presse** (Seattle)	3,040	137	15,700	500	A	B	147	3	Yes	1975	Publisher of *Who's Who* reference books
20. **K&B Engineering** (Santa Ana, CA)	3,021	136	4,400	141	A	B	315	11	Yes	1972	Telecommunications engineering
21. **Crum Electric Supply** (Casper, WY)	2,979	136	4,781	155	C	B	24	1	No	1976	Electrical wholesaler
22. **M & M Products** (Atlanta)	2,934	135	25,983	856	B	B	320	20	Yes	1973	Mfr. personal care products
23. **Jacoby & Meyers** (Los Angeles)	2,833	133	8,800	300	C	C	231	19	No	1972	Retail law firm
24. **Furniture Consultants** (New York)	2,833	133	6,312	215	C	C	27	2	No	1975	Office furniture dealer
25. **Numeridex** (Wheeling, IL)	2,798	132	5,680	196	C	D	54	12	No	1965	Mfr. computer-aided mfg. systems
26. **Potomac House** (Charleston, WV)	2,772	131	3,590	125	A	D	305	3	Yes	1976	Nursing home chain
27. **Food Specialist** (Oakland, CA)	2,765	131	11,017	385	B	B	500	165	Yes	1952	Restaurants
28. **Crafco** (Chandler, AZ)	2,633	129	5,926	217	B	B	50	10	No	1976	Mfr. sealants & road repair machinery
29. **Computer Store** (Sudbury, MA)	2,373	123	10,454	423	B	D	71	5	Yes	1976	Computer retailer
30. **Kassouf Parking** (Cleveland)	2,370	123	4,100	166	C	A	60	10	Yes	1975	Operator of parking lots & garages

*After-tax net income as a percent of sales: A=16% or more; B=6%-15%; C=.1%-5%; D=loss.

One hundred of the fastest growing

Company (by rank)	Sales Growth 1976-80		'80 Sales ($000)	'76 Sales ($000)	Profit range*		No. of employees		Acquisitions '76-'80	Date founded	Business description
	Percent increase	Compound annual rate			'80	'76	'80	'76			
31. **Cotton Machinery (CMC)** (Livermore, CA)	2,355%	123%	$ 9,560	$ 389	C	C	134	11	No	1975	Mfr. agricultural equipment
32. **Advanced Technology** (McLean, VA)	2,286	121	19,113	801	C	B	531	5	No	1976	Multidisciplinary professional services
33. **Vital Signs** (East Rutherford, N	2,233	120	3,500	150	A	C	12	1	No	1972	Mfr. anesthesia equipment
34. **Country Stove and S** (East Hartford, CT)	2,144	118	2,306	103	A	B	9	1	No	1975	Wholesaler of wood/coal stoves & parts
35. **Microcomputer Systems** (Sunnyvale, CA)	2,107	117	11,938	541	C	C	158	18	No	1974	Mfr. controllers & disk drives
36. **Digital Systems House** (Batavia, IL)	2,019	115	2,500	118	B	B	33	3	No	1975	Distributor of business computers
37. **Navidyne** (Newport News)	1,953	113	6,226	303	B	B	115	8	No	1973	Mfr. marine electronics
38. **Early Winters** (Seattle)	1,952	113	6,959	339	C	C	114	25	No	1973	Mfr. tents; retail/mail-order outdoor equip.
39. **Austin-Nelson Construction** (Austin, TX)	1,929	112	11,533	568	B	D	220	20	No	1967	General contractor
40. **Los Alamos Technical Associates** (Albuquerque)	1,900	111	5,000	250	B	B	66	5	No	1976	Engineering consultants
41. **Trend Group** (Valley Forge, PA)	1,774	108	22,112	1,180	B	B	36	4	Yes	1964	Leasor of computers & communications equipment
42. **Tudor Systems** (Charlotte, NC)	1,753	107	2,550	138	B	D	25	2	No	1975	Computer software sales
43. **DHL** (Burlingame, CA)	1,737	107	52,240	2,844	C	D	950	200	Yes	1969	International air freight forwarder
44. **Quorum Clubs of Texas** (Corpus Christi)	1,678	105	1,920	108	B	B	116	10	No	1976	Night clubs & restaurants (5)
45. **Numanco** (Pawtucket, RI)	1,676	105	7,300	411	C	C	175	50	No	1975	Technical services for nuclear power industry
46. **PBM Office Products** (Cleveland)	1,602	103	2,389	140	B	A	36	10	No	1974	Distributor of office products
47. **Alfred S. Buyer** (Needham, MA)	1,564	102	3,631	218	C	C	20	2	No	1966	Recruitment advertising agency
48. **Associated Druggists** (Wichita)	1,455	99	5,485	353	B	C	22	6	Yes	1972	Wholesaler of drugs & retail products
49. **W-B Pump & Supply** (Pampa, TX)	1,451	98	12,446	803	C	B	32	8	No	1971	Oilfield supplier, tubular goods
50. **Knight Equipment** (Costa Mesa, CA)	1,443	98	3,580	232	B	A	56	10	No	1972	Mfr. electro-mechanical systems
51. **Research, Analysis & Management** (Rockville, MD)	1,439	98	2,574	167	B	B	67	8	No	1976	Ship systems engineering & naval support services
52. **Astro Wire & Cable** (Worcester, MA)	1,410	97	8,530	565	B	B	75	10	No	1976	Mfr. wire & cable
53. **Diamond Enterprises** (Salt Lake City)	1,383	96	4,850	327	B	C	49	5	Yes	1971	Rental centers & convenience stores
54. **Design 1** (Los Angeles)	1,368	96	2,935	200	B	B	25	3	No	1976	Commercial interior designer
55. **Microtech Mfg.** (St. Louis Park, MN)	1,359	95	5,794	397	B	C	135	23	Yes	1973	Precision machine shop
56. **Data Electronics** (San Diego)	1,350	95	11,815	815	B	C	300	30	No	1974	Mfr. computer peripheral equipment
57. **Saddlebrook** (Cambridge, MA)	1,333	95	9,247	645	C	D	134	25	No	1974	Computer services for financial institutions
58. **Data Translation** (Marlboro, MA)	1,326	94	4,806	337	B	B	70	6	No	1973	Mfr. microcomputers
59. **Elcan Investments** (Mobile)	1,306	94	2,211	157	B	A	51	3	No	1975	TV & appliance rentals
60. **Telecommunications Specialists** (Houston)	1,305	94	11,065	787	A	B	160	20	Yes	1974	Telecommunications equip. sales/service
61. **Morgan Mfg.** (Paris, IL)	1,300	93	3,500	250	A	A	21	2	No	1976	Mfr. pet food flavors
62. **Western Control Equipment** (Garden Grove, CA)	1,261	92	12,299	904	C	C	350	40	No	1956	Mfr. heaters, infant/medical flotation systems
63. **Wren Associates** (Princeton, NJ)	1,253	92	1,475	109	B	C	37	3	No	1972	Corporate communications services
64. **Vintage Selections** (Scottsdale, AZ)	1,236	91	2,245	168	C	D	17	3	No	1976	Wine wholesaler
65. **Windamatic Systems** (Fort Wayne)	1,234	91	1,699	127	B	D	18	14	No	1971	Mfr. winding machines for electric motors

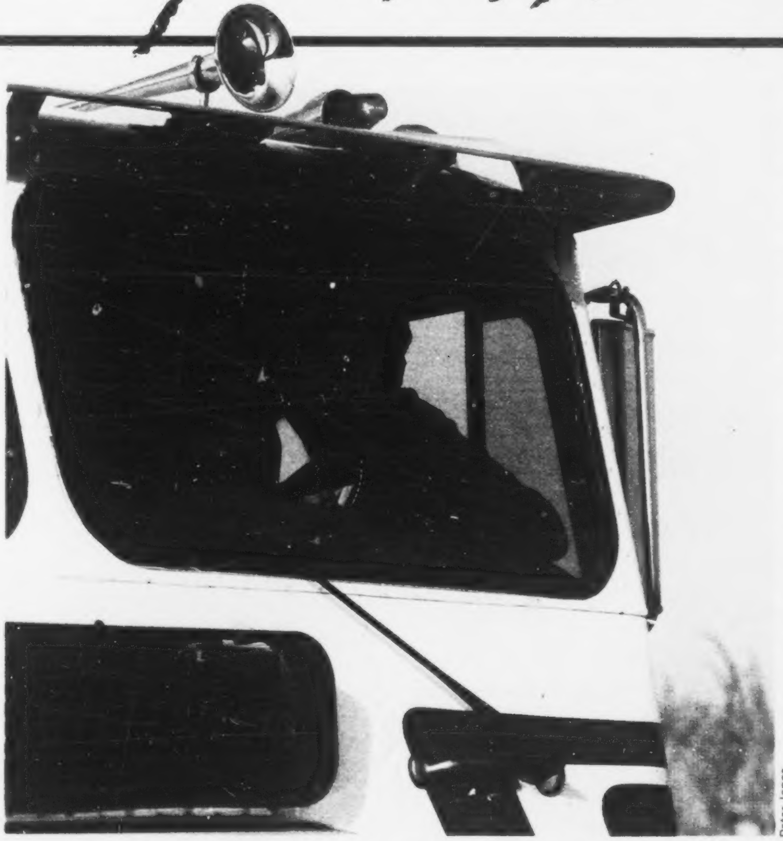
*After-tax net income as a percent of sales: A = 16% or more; B = 6%-15%; C = .1%-5%; D = loss.

privately held companies in the U.S.

Company (by rank)	Sales Growth 1976-80 Percent increase	Compound annual rate	'80 Sales ($000)	'76 Sales ($000)	Profit range* '80	'76	No. of employees '80	'76	Acqui-sitions '76-'80	Date founded	Business description
66. **John Wolcott Associates** (Culver City, CA)	1,233%	91%	$ 4,000	$ 300	A	A	25	3	No	1975	Interior designer
67. **Sun Hill Industries** (Stamford, CT)	1,233	91	2,000	150	A	A	20	3	No	1974	Mfr. clocks & egg decorating kits for mail order companies
68. **Industrial Fabricators** (Jackson, TN)	1,225	91	4,186	316	B	D	78	7	Yes	1976	Industrial wiping cloth converter
69. **Polk Audio** (Baltimore)	1,225	91	3,624	274	B	B	110	12	No	1972	Mfr. loudspeakers
70. **Coastal Compression Service** (New Iberia, LA)	1,214	90	2,269	173	A	B	32	5	No	1970	Services to petroleum industry
71. **Ad-Tek Engineering Services** (Irvine, CA)	1,210	90	2,561	196	C	C	55	8	No	1974	Technical temporary personnel
72. **McCormack & Dodge** (Needham Heights, MA)	1,208	90	15,700	1,200	B	B	251	29	No	1969	Computer software-financial applications
73. **Career Blazers Personnel Services** (New York)	1,190	90	7,804	605	B	C	105	15	No	1949	Personnel employment services
74. **New England Rare Coin Galleries** (Boston)	1,187	89	48,997	3,807	B	C	85	15	No	1969	Rare coin sales
75. **Techexport** (Waltham, MA)	1,169	89	7,589	598	B	C	54	7	No	1971	Distributor of computer products
76. **Denver Spectrum** (Denver)	1,133	87	1,786	145	B	B	40	4	No	1976	Color separator for printing/graphics
77. **Double "L" Mfg.** (American Falls, ID)	1,128	87	1,922	157	B	B	45	5	No	1976	Mfr. potato handling equipment
78. **John Galt** (Hyattsville, MD)	1,125	87	11,696	954	A	A	11	7	No	1974	Fuel oil dealer (retail)
79. **Apollo Bedding** (Cleveland)	1,122	87	1,362	111	A	C	30	10	No	1972	Mfr. mattresses & household linens
80. **Atlas Energy Systems** (South El Monte, CA)	1,121	87	2,182	179	B	C	30	4	No	1976	Mfr. motor-generator power equipment
81. **Decor** (Fairfield, AL)	1,116	87	15,136	1,245	C	C	88	9	No	1971	Mfr. paneling for mobile homes
82. **Progressive Graphics** (Oregon, IL)	1,100	86	15,000	1,250	B	B	390	60	Yes	1972	Full-service printer
83. **Ava Care** (Dallas)	1,100	86	12,529	1,044	D	B	94	18	Yes	1974	Direct sales of cosmetics, vitamins
84. **Century Data Systems** (Raleigh, NC)	1,100	86	4,500	375	B	C	75	8	No	1975	Sales/service of cash registers, minicomputers
85. **Service Industries of America** (Tucson)	1,098	86	5,949	497	B	C	245	10	No	1976	Industrial maintenance supplies
86. **Centec** (Reston, VA)	1,089	86	3,589	302	B	C	80	14	Yes	1975	Computerized process engineering
87. **Medevac** (San Diego)	1,084	85	9,512	804	C	B	337	40	Yes	1966	Emergency medical services
88. **Dallas-Ft. Worth Distributing** (Dallas)	1,081	85	3,615	306	C	B	35	3	No	1976	Furniture wholesaler; waterbeds
89. **Acsis** (New York)	1,080	85	1,770	150	B	C	40	15	No	1975	Computer services
90. **K. S. Inc.** (St. Louis Park, MN)	1,070	85	3,100	265	B	C	90	8	Yes	1975	Sales/service of furnishings
91. **Selective Personnel** (East Brunswick, NJ)	1,063	85	2,325	200	A	A	400	6	No	1974	Personnel agency
92. **Charles Schwab** (San Francisco)	1,058	84	27,800	2,400	B	C	510	80	No	1971	Discount brokerage firm
93. **Sterling Oil & Chemical** (Southfield, MI)	1,037	84	6,622	582	C	C	1	1	No	1976	Mfr. industrial lubricants
94. **American Awning & Patio** (Denver)	1,025	83	2,050	182	C	C	52	29	Yes	1969	Retailer of home improvement products
95. **Brock International Security** (Middlebury, VT)	1,023	83	4,542	404	C	C	320	55	No	1970	Security & investigative services
96. **Raven Systems & Research** (Washington, DC)	1,021	83	7,577	676	B	B	385	127	No	1971	Computer & data management services
97. **Input** (Palo Alto)	1,004	82	3,280	297	D	B	37	8	No	1974	Management consulting
98. **B.W. Levy Security Consultants** (Chicago)	991	82	1,200	110	B	A	75	6	No	1975	Public safety & security consulting
99. **Reactive Metals & Alloys** (West Pittsburg, PA)	983	81	20,651	1,908	B	C	200	30	Yes	1975	Mfr. metallurgical additives & compounds
100. **Phone Directories** (Provo)	972	81	1,538	143	A	B	12	7	No	1973	Publisher of independent phone books

*After-tax net income as a percent of sales: A=16% or more; B=6%-15%; C=.1%-5%; D=loss.

The INC. Private 100



Peter Jones

#1, STOOPS EXPRESS—9,372%

Jeff Stoops got started in the trucking business when he realized that truckers were making $10,000 a year more than he was as a junior high school teacher. Ten years later, Stoops Express operates 137 trucks, and the firm's 34-year-old president and sole owner predicts that his company will bring in $15 million this year.

Hidden behind cornfields at the junction of I-69 and State Road 67 near the tiny town of Daleville, Ind., Stoops Express doesn't look like a transcontinental transportation company. But Jeff Stoops didn't set out to build a trucking empire.

As a student at Ball State University, Stoops first drove trucks in the summer for a grain elevator in Emporia, Ind. He graduated in 1969 and got a job teaching social studies and coaching football and basketball at a small junior high school, but he kept driving during summer vacations.

"In 1971, I looked around and saw truck drivers making $18,000 a year while teachers were making $8,100," Stoops recalls. He decided to quit teaching to drive a truck, but his father talked him out of it. Instead, Robert Stoops, a Buick and Pontiac dealer in Elwood, Ind., helped his son finance the purchase of a tractor-trailer, which he leased to other trucking firms. By 1975, Stoops had a fleet of 12 trucks that were hauling material for the auto and steel industries.

That was the year, however, that the automobile recession hit the Midwest's economy, idling half of Stoops's rigs. Ask Stoops about the recession and he just smiles. "That was the best thing that ever happened to us," he says. "If it weren't for the auto recession, we'd still be hauling steel around the Midwest—which means not doing much business."

Stoops had the inspiration to buy refrigerated trailers and to establish a series of routes to California, shipping manufactured parts and retail goods for *Fortune* 500 companies and back-hauling fresh fruits and vegetables to supermarket chains in the Midwest.

"That recession taught me a lesson," he says. "One thing that moves all the time is food."

Stoops Express was founded in 1976 when Stoops decided to quit leasing out his trucks. He applied for and received the Interstate Commerce Commission licenses needed to operate on his own. He went to the ICC with the backing of his major Midwest-based customers who, he says, "feel more comfortable dealing with a midwestern trucker." He repays their support by providing financial statements "to prove that we're not trying to hit home runs off of them."

Dressed in a V-neck sweater and casual slacks, Stoops still looks more like a junior-high coach than a truck driver or a corporate executive. He last drove an 18-wheeler in the spring when he and his son Matt "stole the show" on show-and-tell day at Matt's nursery school. Now he spends most of his 10-hour days in the office of Stoops Express, supervising 38 employees and 150 drivers.

He's also working to protect his company from the eventual slump he expects in long-haul trucking. Because of fuel costs and deregulation, he believes that truckers will have to give up routes of 1,000 miles or more to railroads, whose "piggyback" services offer greater efficiency and flexibility.

"But I'm not going to sit back and let the railroads take away my business," says Stoops. He's established a promising short route to Chicago where many trains pick up trailers to piggyback to California.

Six who made the list

Andrée Abecassis

#31, COTTON MACHINERY CO.—2,355%

Back in 1976, FMC Corp., a $3.3-billion conglomerate, was trying to get rid of a monster it had created. The monster was a cotton module builder, a giant machine that compacts cotton into bales 32 feet long by 7 feet high by 8 feet wide.

Jeff Johnson was manager of FMC's new-business venture group and one of the few people who believed in the machine. When he learned that FMC was going to scrap plans for building it, he volunteered to try to sell the idea to other companies. When that didn't work, he decided to buy it himself. He and another FMC colleague set up shop as Cotton Machinery Co. (CMC) in Livermore, Calif. (Nowadays, 75% to 80% of the cotton grown in the United States comes from California, Arizona, and Texas.)

"When we started in 1976," says the 42-year-old Johnson, "we believed we had a viable product. But we had no idea it would be this viable. Sales this year will top $11 million."

CMC's success, says Johnson, stems in part from manufacturing equipment that helps farmers store and transport large quantities of cotton at low cost. But it also stems from Johnson's insistence on keeping the company trim and flexible. He maintains a minimal inventory, farming out almost all parts manufacturing, and he cuts his work force during the winter and spring, when almost no manufacturing takes place.

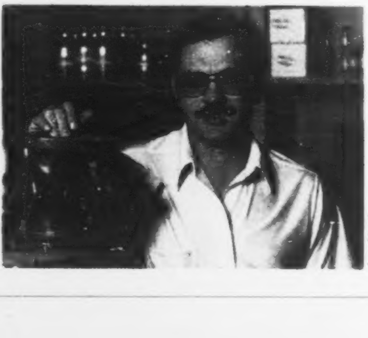
Long lead times for purchasing and fabrication force the company to plan the production of their machines a full year in advance. "It's always tense, planning a year ahead, knowing you can't turn back," says Johnson. "But like a fire horse going to the fire, you get used to it, and, fortunately, our bank believes in our projections."

#49, W-B PUMP & SUPPLY CO.—1,451%

"I can walk down the street in Casper, Wyoming," says Texan Ronald Hess, "and I'm bound to run into somebody I know. The oil business is really a relatively small circle of people."

Hess's familiarity with the industry and its people has helped him build W-B Pump & Supply Co. into a $27-million business. The company started in 1971 as a two-man operation in Pampa, Tex., selling oil-field pumps.

W-B's success has brought him a lot of offers from larger firms wanting him to sell out. But Hess says that after starting with practically nothing, he intends to hold on to what he built.


Joe Abell

"This company still has a long way to go," he says. "I figure if it would be all that good a deal for the conglomerates, then it's a good deal for me."

Hess, 38, was a manufacturer's representative for Dover Corp., selling oil-field pumps, when he bought W-B in 1971. He was born 12 miles from Pampa in Lefors, where his father worked for Texaco. "I was raised in oil-field camps on company leases," Hess says. "All I've ever known is the oil patch."

He put up his house and his car for a loan to buy the business, whose sales were running at $4,000 to $8,000 a month. Today, W-B sells much more than pumps. Headquartered in the Texas Panhandle, with six retail stores and two sales offices in Texas, Colorado, Kansas, and Oklahoma, W-B retails field supplies to the oil and gas industry.

With sales expected to hit $50 million next year, Hess says, "I've always had more growth than anything else." And although he's not going to sell out, he says a stock offering is in W-B's future, probably next year.

#69, POLK AUDIO INC.—1,225%

A year out of college, George M. Klopfer and Matthew Polk were building large public address systems for fiddlers' conventions. Now, a decade later, Polk Audio Inc. in Baltimore is scoring heavily in hi-fi stereo speaker markets against big league companies like Sony, Pioneer, and Technics.

Penelope Breese/Gamma Liaison

The two started out with a used bench saw they bought for $25, setting up shop as roommates in a tiny cot-

continued on page 48

tage. "We didn't know anything about anything," Polk says, but a Washington, D.C., retailer found they at least knew how to make quality speakers and he contracted them to make private-label speakers for his store.

"We were basically brokering the systems until the deal fell through several months later," says Klopfer.

Stuck with an inventory they thought was already sold, Klopfer, Polk, and new roommate Sandy Gross were forced to redesign their product and go out and market it themselves. Their first model, the Polk Model 9, got some encouraging attention.

The trio moved into a large old Victorian house in Govans, Md., and got serious about engineering their next model. "We adapted a lot of good features from European audio components into features acceptable to American consumers," says Polk, 32, vice-president for engineering.

Orders began to come in, but the new company was cash-poor. The trio managed to land a $75,000 Small Business Administration loan in 1976 to finance production and the next year, their business quadrupled to over $1 million. Two more SBA loans followed.

Today, Polk Audio has 110 employees and produces 1,000 speakers a week on an assembly line that would make Henry Ford proud. And it didn't hurt business when Klopfer, the company's 31-year-old president, was named Maryland's Small Businessman of the Year in 1978.

#77, DOUBLE "L" MANUFACTURING INC.—1,124%

As a professor of agricultural engineering at the University of Idaho in Moscow, Lynn F. Johnson gained fame for his knowledge about potatoes and how they should be handled—in a word, gently.

Five years ago, a potato farmer named Leland Clinger, from near Pocatello, convinced Johnson that he could do more good for agriculture by getting out of his ivory tower and designing the equipment that would help keep potatoes unbruised. Lynn and Leland (who is no longer with the company) incorporated in 1976 under the name Double "L" Mfg. Inc. and started marketing Johnson's first prototype system.

Johnson's equipment, for which many of his buyers are willing to pay 100% in advance, helps get the potatoes from the field to the storage buildings on self-unloading truck beds. (That's a plus for the truck drivers, 70% of whom are housewives who sign up for the one-month harvesting season.) Once at the storage building, other pieces of Double "L" equipment sort the potatoes into different sizes, and then pile them, neatly and gently, so they can be picked up for the last leg of their trip to the market.

"Although we started up in the worst possible economy," says Johnson, "the prototype sold before it was completed, and it's been that easy ever since."

Sales in 1980 were $2 million. With orders coming in a year or more in advance, Johnson predicts that Double "L," based in American Falls in southern Idaho, will increase its production 2½ times within the next few years. But Johnson sees one problem: The company needs to move from custom design work into standardized production as soon as possible. Johnson is considering going public—or "maybe finding another rich partner."

Andrew Rafkind

Rhoda Baer

#96, RAVEN SYSTEMS & RESEARCH INC.—1,021%

Last year, one of the security guards at Raven Systems & Research Inc. came upstairs with $2,000 to find out if he could invest it in the company. He had to be turned away because Ray Mott still owns it 100%.

Mott moved to Washington, D.C., in 1960 and worked as a waiter and a model before joining a data processing firm. By 1971, he had become a general manager of the firm, but left to start Raven, his own information processing firm.

"I lost 72 hours of sleep trying to decide if I was doing the right thing," he recalls. "I had none of the tickets, such as a formal education, but I figured I had nothing to lose. I could always go back to waiting tables."

That probably won't be necessary. The company last year grossed $7.5 million.

Mott, 42, is quick to point out that he owes much of his success to the government—85% of his business is government contracts, many of which have come through the Small Business Administration's 8(a) program, which sets aside contracts for minority businesses.

Raven's biggest jump in sales came in 1979 when it won a $4-million contract from the Environmental Protection Agency to process confidential data from pesticide firms on the chemicals used in their products. To handle the project, Raven had to add 150 new employees to its staff of 112.

But working for the government also has its frustrating side: "Some of our contracts got blown out of the water this year, because of Reagan's budget cuts," says Mott. That has triggered his desire to cut some of the apron strings to government by raising private sector contracts from 15% to 50% of the total.

And someday soon, he says, he also plans to have a different answer for the security guard.

Inc.

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GROWING COMPANIES

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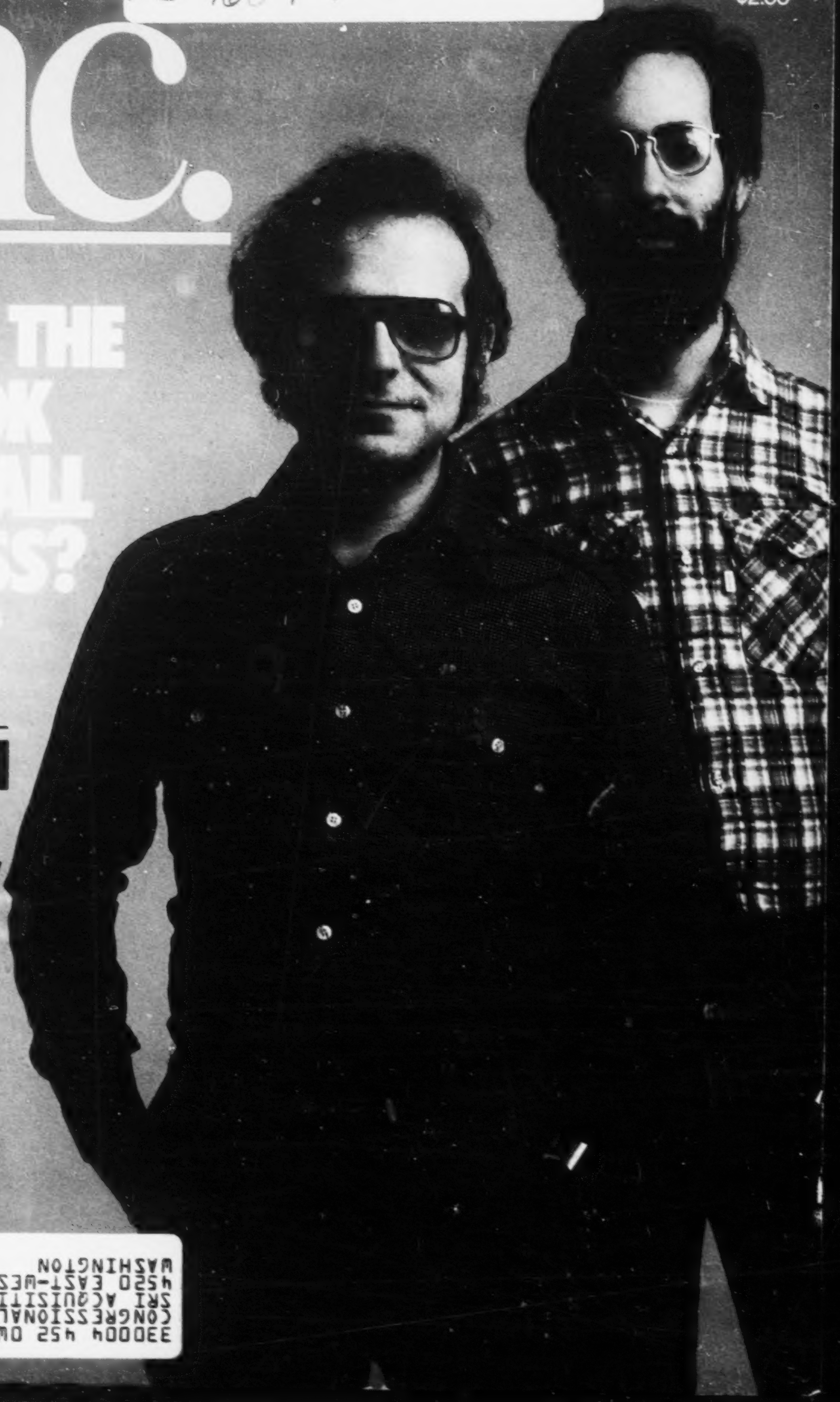
The Year Ahead

WHAT'S THE OUTLOOK FOR SMALL BUSINESS?

INC. asked hundreds
of businesspeople
what they think.

THE BIRTH OF A NEW INDUSTRY

Bob Frankston and
Dan Bricklin of
Software Arts Inc.



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JANUARY 1982

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Cover photo
Peter Jones

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Economic Outlook

WHAT'S GOING TO HAPPEN IN '82?

INC. asked hundreds of businesspeople what they think this year will be like.

It can be lonely running a small business. There's nobody to tell you how you're really doing. Are sales down because of your own mistakes, or because the economy is in a tailspin? Are profits up because you're smart, or because you're lucky? What should you do about it now?

Economic news and economists' forecasts are only marginally relevant to any specific firm. Currently, for example, the seers are debating whether we're in a recession. Some businesses are, some aren't. So much depends on your customers, your competitors, your suppliers. How are *they* doing? What are *their* plans?

Talking to people, in fact, is how most small business managers formulate their own economic outlook. When they ask "How's business?" they're not exchanging pleasantries. They really want to know.

This article looks at the year ahead the way every business owner would like to: by talking to hundreds of other businesspeople.

INC. approached the 1982 outlook in two ways. First, we convened three forums of about 20 small businessmen each, along with a sprinkling of economists, bankers, and accountants who specialize in small business. All are experienced, active small business leaders in their communities or industries. These groups met in Phoenix, Chicago, and Boston this past October and November to ask each other "How's business?" A stenographer recorded their conversations. We have excerpted highlights

Illustration: © Jim Kingston 1981

from the forums on the following pages.

INC. also sent a questionnaire to a sample of the magazine's subscribers. Approximately 2,000 small businesspeople gave us detailed answers to questions about their business growth, their biggest worries, and their opinions about the economy. More than three-fourths of those answering were owners or top executives of small businesses, and almost all the rest were in charge of finance, marketing, sales, or production. About half of the companies have annual sales up to $1 million; the other half range up to about $50 million. All the charts and figures in the article are compiled from this survey.

The article is divided into six sections: credit, business growth, the Reagan Administration's policies, inflation, labor, and regions and industries. Each section begins with a summary of the survey results pertaining to that topic; the rest consists of verbatim remarks by our meeting participants and subscribers.

Regard this article as a visit with your business associates and friends. Listen for trends the way you do in your daily talks with colleagues and customers. Take note when people contradict one another. And let us know what you think.

Table 1: Most important economic factors to small business in 1982

Factor	Weighted score
1. Interest rates	192
2. Growth of the economy	48
3. Availability of long-term credit	40
3. Ability to pass on price increases	40
5. Availability of short-term credit	38
6. Wage costs	29
7. Energy costs	25
8. Raw materials costs	22
9. Quality of labor	21
10. Federal taxes	19
11. Domestic competition	18
12. Regulatory environment	15
13. Federal spending	14
14. Availability of equity capital	12
15. Availability of labor	8
16. Foreign competition	8
17. State/local taxes	8
18. Government aid for small business	7
19. State/local spending	6
20. Stock and bond markets	5
21. Mergers and takeovers	5
22. Supply of energy	4
23. Union activity	4
24. Foreign exchange rates	4

Interest rates topped this list on the following vote by INC.'s sample of subscribers: 53% chose it as their most important concern in 1982, 12% chose it as second most important, 8% chose it third, and the remaining 27% didn't put it among their three major worries. Its score of 192 points comes from giving a weight of 3 to the percentage of times it was listed first, 2 to the times listed second, and 1 to the times listed third. The highest possible score that any item could receive would have been 300 (3 x 100%)—if every respondent had listed that as top concern.

Interest rates obviously overwhelmed all other items, garnering four times the score of the runner-up—growth of the economy—which received this vote: 7% gave it first place, 9% second place, and 10% third place, for a weighted score of 48.

Rick Friedman

Robert E. Carr, Sr., president, SEACOR, Cherry Hill, N.J.

CREDIT

Interest rates will dominate the economic news in 1982 as they did last year. High borrowing costs are wreaking such havoc with income statements that other business worries pale by comparison. In INC.'s subscriber poll, interest rates were voted the major concern for 1982 by a four-to-one margin over the next item on the list (see table 1). In a separate question, about two-thirds of those responding said that tight monetary policy will significantly hurt their company.

To the smallest firms answering our survey, tight credit means that money will be not only expensive, but unavailable at any price. While survey respondents as a whole voted *availability of short-term credit* as their fifth biggest worry, giving it a weighted score of 38 points out of a possible 300 (see table 1 for an explanation of these scores), smaller companies—those with annual sales of less than $1 million—gave it second place, or 48 points. By contrast, companies with sales of $10 million or more placed credit availability far down on their list, giving it a score of only 19.

What's all the more troublesome, many companies need more financing at the very time that financing is hardest to get. Large and small customers are stretching out their payables, forcing suppliers to finance their receivables for longer periods.

Though short-term credit is expensive and sometimes hard to obtain, long-term credit has come close to disappearing. Availability of long-term funds tied for third place, with a score of 40 on our subscribers' list of concerns for 1982, with firms of all sizes in close agreement about its importance.

Curiously, equity capital—a possible replacement for long-term debt in some cases—ranked low on the list of economic concerns. Smaller companies gave it the most mention, for a weighted score of 14; the overall score was 12; and for companies over $10 million in sales, only 8.

Venture capitalist Stanley Golder, general partner of Golder, Thoma & Co., Chicago, says that capital is available now for products oriented toward costs savings and productivity enhancement. Demand for these will be "less sensitive, if not insensitive to interest rates in growth years," he says. One important source may become institutional investors, which traditionally have ignored smaller companies.

There's still a long way to go, though, before most of that money would be available to small businesses. Insurance company investments are closely watched by state regulatory bodies, and private pension funds by federal "prudent man" rules. Most of these limit investments to larger, publicly held companies. Many of these laws would have to be changed before the funds could invest in smaller businesses.

Small business owners are looking with trepidation toward credit markets in 1982. Their only consolation may be that the year will hold fewer surprises than 1981. Just about all economists agree that interest rates will stay in the double-digit range for some time to come.

Subscriber. "Our money, if we sold our assets, would be better invested in a money market fund. I see no way of earning 16%—we earn only half of that."

Economist. "Everybody thinks that when the Treasury continues to finance 10 years out at high interest rates with no recall on the bonds, that means it expects inflation. The markets are not ignoring it. They look at Social Security deficit potentials, and they say it could mean the Treasury knows that it is going to be borrowing $200 billion in five years."—*William C. Dunkelberg, professor of economics at Purdue University, Lafayette, Ind., and economic consultant to the National Federation of Independent Business.*

Banker. "It looks to us like the continuation of perilous times in financing for small business. Even if interest rates come down substantially, the funding cost to financial institutions is going to continue to go up. The financial institutions are being changed by the bank deregulation act of 1980. As each month goes by, they have to finance an increasing part of their pool of funds at current market rates, driving their overall cost of funds up."—*B. Paul Jones, senior vice-president, Valley National Bank of Phoenix.*

Government economist. "As long as the Federal Reserve Bank has this federal deficit to fund, it either has to print money or dominate the debt markets, pushing up interest rates. I see no break in interest rates until we get a more nearly balanced budget.

"Why were we able to run a federal deficit at a higher percentage of gross national product in the 1960s, and not able to do it today? Because then we were able to export our inflation. Dollars would flow out of the country for imports or for investment abroad, and they would pile up in foreign central banks. We are no longer able to do that because foreign central banks don't want to hold any more dollars. I think that Chairman Volcker of the Federal Reserve sees this more clearly than the average citizen. He had no choice but to push up interest rates."—*William B. Whiston, director, Office of Economic Research for the U.S. Small Business Administration.*

Trucking company president. "We have almost doubled the number of people working on accounts receivable. Some very, very large companies back East are investing their money rather than paying their bills. We have called them and said, 'If you don't get your account paid in 10 days, we will cease service.' In three or four cases we have done that, and I'm talking about companies in the top 500. In every case, the company has come back to us and agreed to meet terms within the normal 20 or 25 days.

"These companies are very substantial. They just can get more investing their money. I think, whenever possible, they are taking it out on the smaller people they deal with.

"I have been in this business about 28 years. Before now, the swings in revenue were never more than 20% or 22% between the best day in a month and the worst day. Now that swing is up to 35%.

"I believe the reason is that people are ordering late and the shipping is being done at the last minute. At the end of each quarter, we're seeing a lot of orders. I think the sole purpose of that is to make that quarter's balance sheet or P&L statement look a little bit better, probably for our banker friends."—*John A. Pifer, president, Best-Way Transportation, Phoenix, a common carrier serving the Southwest, with about $20 million in sales in 1981 and 400 employees.*

Subscriber. "Small companies must rely on debt financing for major capital projects. When they have to compete for people's savings with the U.S. Treasury, they lose."

Investment banker. "I think that many businessmen are realizing that if they are going to get money, they are going to have to give up some equity. More and more are coming around to that point of view.—*E. David Collidge III, partner and manager of corporate finance dept., William Blair & Co., Chicago.*

Banker. "We'll be taking a much harder look at companies' credit. I'm going to be very, very selective as to who's going to get funds. The corporate sector of the economy is highly illiquid, and it's not going to get liquid soon. It's going to take a long time."—*Nathan C. Collins, senior vice-president, Valley National Bank of Arizona.*

Glenn Short

Left, Bernard Z. Lee, CPA, managing partner, Seidman & Seidman, Houston; right, John A. Pifer, president, Best-Way Transportation, Phoenix.

Banker. "Receivables are lengthening on a lot of our customers. It is taking more time to work with those firms and to provide some management assistance. We are quite concerned that a number of our small business accounts can't withstand interest rates that never go down. I think they can weather the first year or two years or three, but when there's no rainbow in sight, it's going to have a definite effect—more mergers, sellouts, bankruptcies, liquidations."—*Victor H. Frank, executive vice-president, Thunderbird Bank of Phoenix.*

Manufacturing company president. "What killed us last year was not the level of interest rates—it was the way they went way beyond what we expected. We announced our programs, but we didn't anticipate interest costs in setting our prices. Next year we will factor that into our prices—because we now assume that rates are going to stay high.

"Our back orders for this year are the best ever, but our customers are slower in payment than they have ever been. We are worried as much about what interest costs will do to our customers as what they will do to us. A year ago, we had our largest single bad-debt writeoff ever—somebody who had been a good customer for many years couldn't make it."—*David Ransburg, president, L.R. Nelson Corp. in Peoria, Ill., a manufacturer of lawn sprinklers and garden products, with 400 employees.*

Engineering company president. "We will probably have a 25% sales increase in 1982, but the profit is going to be way off. It takes every bit of imagination you can muster today to make collections work. You have to start looking at the total system of invoicing and recovery.

"Financing, production, and sales are a three-legged stool. What we're seeing is that top management of small companies are all concentrating on financing—neglecting, perhaps, production and the marketplace. We're spending a lot more time this year on the doggone cash problem than ever before."—*Robert E. Carr, Sr., president, Systems Engineering Associates Corp. (SEACOR), Cherry Hill, N.J., naval architects and marine engineers, with $14 million in sales and 450 employees.*

Accountant. "About two years ago, small companies became aware of the need to help their working capital for their cash flow. They started with tightening receivables. Then about six months later they went to inventories. About a year ago, they started on an austerity program in spending.

"Now we've gone through all available means, and we have run out. Small business that we see has run out of means to pare back and survive."—*William Barth, director of small business practice for Arthur Andersen & Co., a big-8 accounting firm based in Chicago.*

Automobile dealer. "Interest rates are certainly killing the retail end of our business. Even though rates have slowly started down, there are now fears for the future on the part of the consumer. They are afraid to make large purchases."—*Shepard Lee, president, Lee Management Co., Auburn, Maine, with five dealerships, annual sales of about $25 million, and 200 employees.*

Economist. "People in the building industry say that the magic interest rate might be about 13% or 14%. If mortgage rates come down to that, there is a tremendous unrealized demand out there. The post-war baby boom babies are coming of age right now, and the demand for housing is going to be substantial.

"Thus, I think there is some sort of built-in floor to the economy when interest rates start to come down. The two major industries ought to rebound fairly quickly: automobiles, when the short-term rates come down, and housing, when long-term rates come down. The economy may come down fairly sharply, but may recover fairly quickly in the latter part of 1982."—*John E. Buehler, professor of economics, University of Arizona, Tucson.*

BUSINESS GROWTH

While the economy this year promises to resemble that of 1981, small business investment may take a dive from last year's level. The INC. survey shows that among firms with less than $1 million in sales, 30% made a significant modernization, capital investment, or improvement in 1981; given the same circumstances, again, about one-third fewer—only 21%—say they will do so this year. Among larger firms, the figure also drops by about a third, from 41% in 1981 to 25% in 1982 (see chart 1).

Many small business managers, though, exhibit a streak of optimism. This shows up in growth rate estimates for sales, profits, and employment (see chart 2). Most of them predict a decided upturn this year after 1981's dive.

Why the discrepancy between these optimistic predictions and the pessimistic ones about investment? The investment question on our survey told respondents to assume 1982 would be a rerun of the past year; the growth questions did not. Free to make their own assumptions, small business managers look on the bright side of things.

Smaller companies seem to foresee a stronger uptick in 1982 than do larger ones. Do they know something larger companies don't?

Chart 1: Small business spending

QUESTION: Has your firm made a significant modernization, capital investment, or improvement in 1981? Do you think it will do so in 1982, if the economy continues like 1981?

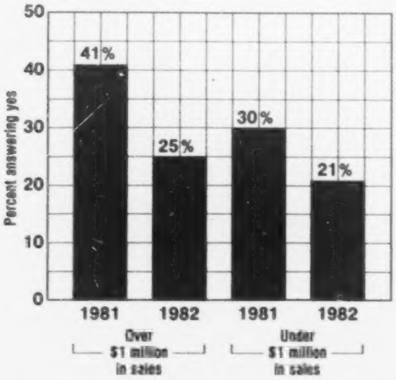
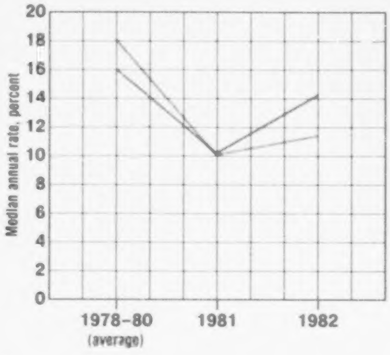


Chart 2: Small business growth

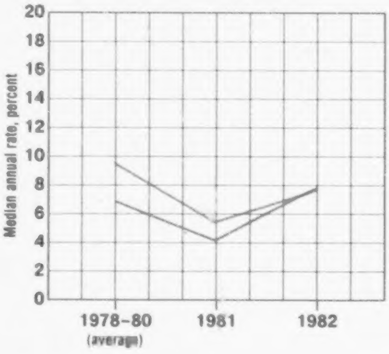
Sales

QUESTION: What is your firm's sales growth for: 1978–80 (average annual rate); 1981; your estimated rate for 1982?



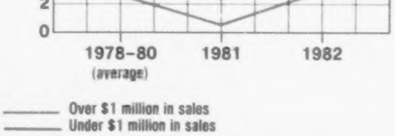
Profits

QUESTION: What is your firm's after-tax profits growth for: 1978–80 (average annual rate); 1981; your estimated rate for 1982?



Employment

QUESTION: What is your firm's employment growth for: 1978–80 (average annual rate); 1981; your estimated rate for 1982?



Richard Marin

Mel Boldt, president, BMI Inc., Des Plaines, Ill.

Banker. "A lot of small businesspeople are pretty well informed about the economy, but they don't believe what's being said. They have a tendency to be optimistic—as an entrepreneur just starting out might be. They are hesitant to, say, cut back their production or cancel orders, because they feel it might only be temporary and they don't want to be left out in the cold."—*Victor H. Frank, executive vice-president, Thunderbird Bank of Phoenix.*

Manufacturing company president. "Business is not very good right now. It's a time to really get the equipment in shape, get the organization built a little better, and get a lot of training done. That's the way we look at it. Long-term, we are very optimistic."—*Frank Labriola, president, Pimalco Inc., an aluminum products manufacturer in Chandler, Ariz., with sales of $12 million and 100 employees.*

Construction materials executive. "We are looking right now at nine tough months ahead of us. We do plan to spend some money in spite of the down nature of housing, principally because we think that the demand for housing may flatten out. We are going to have to become more productive, and we are planning to spend more money in our three lumber mills to increase productivity."—*Richard A. Fletcher, vice-president of finance, Kaibab Industries of Phoenix, a lumber manufacturer and building materials distributor.*

Accountant. "We have seen a lot of companies in the last couple of years that have produced no bottom line, especially in 1981. A lot of them have forgone expanding. They are trying to hold on to their cash flow and just reinvest it in doing the day-to-day operations of the business."—*Norman W. Nagel, principal, Ostrow Reisin Berk & Abrams Ltd., Chicago, a 42-man accounting firm that deals exclusively with family-owned and privately held businesses.*

Economist. "For the long run, my group of economists forecasts real economic growth averaging 2.9% over the next five years. That would have to mean that 1983, 1984, and 1985 will be better than 1981 and 1982, which will average under 2%. They see a somewhat better growth rate for the last half of the 1980s."—*Robert J. Eggert, president and chief economist,* *Eggert Economic Enterprises Inc., Sedona, Ariz., and editor of* Blue Chip Economic Indicators, *a newsletter that summarizes the forecasts of more than 40 leading economists.*

Manufacturing company president. "We are going through a period of weeding out of the weak, and I think this is good. There is a tremendous emphasis on quality. This means we all have to increase inspection equipment and automation equipment. It's a more capital-intensive business to maintain the types of quality standards we need to meet the world market.

"This weeding out is going to be very traumatic. On the other hand, many small businesses in this field don't operate to these same standards. It's very easy to get in by cutting prices, feeding your customers junk, and giving your product a bad name. We have to upgrade productivity and quality as a result of this shakeout.

"The one problem we are having is profitability. Our sales have been growing, but we're hurt in New England by energy, costs of government, and pressure on the small business market as a result of pricing. Our region is under attack from the Midwest production surplus that has been freed up by Detroit. I think it will continue to be a buyer's market."—*William B. Anderson, president, Matrix Inc. of East Providence, R.I., manufacturer of custom plastic components for the electrical transmission industry, with about $5 million a year in sales and 65 employees.*

Manufacturing company president. "We have used this last year to acquire about four pieces of production equipment at prices that I couldn't believe. We paid $25,000 for a couple of presses and a couple of multi-slides. Three years ago, even used, it would have been twice that. We filled up the plant with equipment."—*Mel Boldt, president, BMI Inc., Des Plaines, Ill., a manufacturer of formed metal parts with about $1 million in sales and 15 employees.*

Computer software company president. "Our products are computer software for financial applications. All of our customers are large companies—the typical product that they buy from us costs close to $100,000, and might be part of a $500,000 project. So typically, it takes some time to make this spending decision; committees have to agree. When they get cautious, everybody gets cautious, and there is a slowdown in the decision making.

"But our principal product is a credit and accounts receivable system, the attractiveness of which is that it increases cash flow. Though we will be a little short of our forecasts, we expect final figures on 1981 to show 30% growth again. The software business is expected to grow at that rate for most of the 1980s."—*Douglas C. Jerger, president, Fortex Data Corp., Chicago, with about 60 employees and annual sales of about $6 million.*

Glenn Short

Gaye Conrad Kruglick, owner, Earl's Academy of Beauty, Mesa, Ariz.

GOVERNMENT POLICIES

Small businesses offer mixed reactions to Reaganomics. By and large, they say they're for it. But that hides an undercurrent of fear—fear that they'll be crushed in its path. This ambivalence is exhibited dramatically in INC.'s survey.

On the positive side, more than a third of our sample say the President's program will have a significant positive effect on their companies in 1982, versus only 11% who think the opposite (see chart 3). Larger companies in our sample—those over $10 million in sales—are even more favorably inclined toward it: Almost one-half of them see a significant positive effect, with only 7% seeing a negative one.

Perceptions of the Reagan program's benefits, though, apparently depend on how strong one's company is. Among companies that reported a significant modernization in 1981, 44% foresee a positive effect; among those who had to postpone modernization, only 26% do (see chart 3).

On the negative side, almost two-thirds of our respondents think that the President's program will help large companies more than small ones. Smaller companies are more likely to hold this opinion, though even among the larger firms in our sample—those over $10 million in sales—about half agree. No more than 4% of the companies in any group say the converse—that Reaganomics will help smaller firms more than larger ones. The remainder say either that it will affect all companies equally, or that they're not sure what effect it will have.

Has Reagan acquired the tag of big-business president? From this evidence, it seems the Reagan Administration has, at least, a public relations problem.

If you were one of President Reagan's advisers, what would you tell him to do about the economy? Small business's split personality regarding the Reagan program comes through in the replies to that question. Two conflicting themes tied for first place, standing head and shoulders above all others: "Stick to present course" and "Bring down interest rates." Each was mentioned by 26% of people offering advice.

The interest rate remark comes from companies of all sizes in about equal proportions. But those saying "continue on course" tend to be larger companies. Only 20% of those under $500,000 in sales say that, but the percentage rises with size, with 37% of the largest group, those above $50 million, telling Reagan to charge ahead. The smaller the company, it seems, the less pleased it is with Reaganomics.

Small business is loath to ask for special help, though. Government aid for small business receives a weighted score of only 7 points in the list of most important economic factors in 1982 (see table 1), putting it in 18th place. Even the smallest firms give it only 12 points, for 14th place on their list. Federal taxes, government regulation, and federal spending all rank higher.

By sizable majorities, small businesses agree that they'll be helped by the new depreciation rules, new investment credits, reduced capital gains taxes, and regulatory relief. But again, larger companies say so more strongly than small (see chart 4). That fact shows up another way: Companies under $1 million in sales give a considerably higher score in table 1 to federal taxes as a source of concern in 1982 than do those over $10 million: 23 points versus 11, for an overall average of 19.

Chart 3: Opinions of President's economic program

QUESTION: Based on your understanding of President Reagan's economic program, what effect do you think it will have on your company in 1982—significant positive, significant negative, little, or not sure?

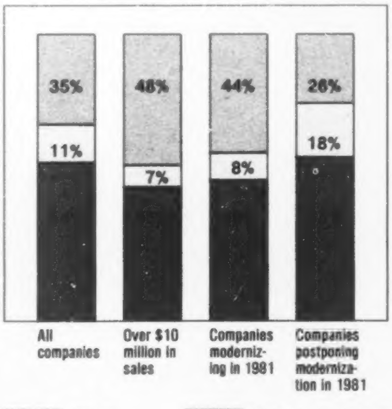


Chart 4: Who likes what about the Reagan program

QUESTION: Please indicate whether any of the following aspects of Reagan's program will significantly help your company.

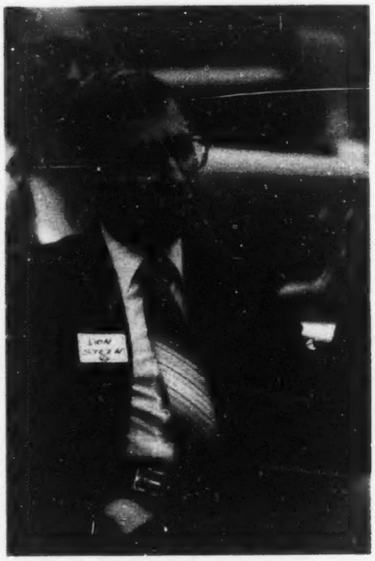
	Percent answering yes	
	Companies up to $1 million in sales	Companies over $10 million in sales
New depreciation schedules	81%	91%
New investment tax credits	67	81
Reduced capital gains taxes	57	64
Regulatory relief	52	69
Increased defense spending	25	36

Distribution company president. "We were going to build a new building, but to do that in Chicago costs in excess of $40 a square foot. We were able to buy an older commercial structure for substantially less. Under Reagan's new tax package, any building over 40 years old that is purchased and substantially rehabilitated carries a 20% tax credit.

"Everything that we have looked at as far as urban revitalization has been economical. We expect to take advantage of any program that will help us survive in an urban setting. The problem is that not enough people, both small business and minority business, know enough about the programs and how to use them."—*Joseph A. Williams, president, Arrow Services Inc., Chicago, a commercial/industrial laundry and distributor of uniforms and paper products, with annual sales of about $2 million and 50 employees.*

Electronics company president. "One of the unfortunate things about the new Individual Retirement Account and Keough rules is that they will drive that money into a form that small business will never get near. No fund manager is going to put that money into small business—he can't do it with his investment restrictions. The money will go to build Section 8 housing, for oil deals, and into listed securities.

"In the near future, large businesses will benefit more from the new investment tax credit rules. Over the long term, smaller business might benefit as much. But it will take the average small businessman years to understand them, and even then only those with sophisticated advisers will come close to being able to take advantage of them."—*Oliver O. Ward, president, Germanium Power Devices Corp., Andover, Mass., a manufacturer of germanium semiconductors, with about $5 million in annual sales and 100 employees.*



Glenn Short

Don S. Stein, president, K-Tron International, Scottsdale, Ariz.

Manufacturing company executive. "Our attorneys and accountants foresee any gain for us from the Economic Recovery Tax Act over the next two years being negated by increased fees on their part explaining to us what it's all about."—*Paul Reid, vice-president and general manager, Barnes & Jones, Newtonville, Mass., a manufacturer of steam traps and valves with $3 million in sales and 60 employees.*

Director of an industrial revenue bond agency. "Everyone has criticized industrial revenue bonds on the basis that they're being widely overused, abused, and that big companies are using them. A lot of commentators, including one on '60 Minutes,' have overlooked the requirement that we can't invest more than $10 million in a plant in a given municipality. That has limited their use primarily to small business. In Massachusetts, three-quarters of the companies we financed in 1981 have sales under $20 million, and half of them under $5 million. The Congressional Budget Office found that 93% of all such bonds nationally over the past two years went to companies not listed on any stock exchange, and therefore dependent on their local banks.

"A combination of the Treasury bureaucrats, who don't like tax-exempt financing at all, and the aura that the media have created, has resulted in an extremely difficult environment. The small business groups nationwide have not been sufficiently out front on this."—*Robert E. Patterson, executive director, Massachusetts Industrial Finance Agency, Boston.*

Subscriber. "The President should proceed slowly with change. The economic mess didn't happen overnight. Too rapid a cure is probably more harmful than allowing the deficit and inflation to slow gradually."

Manufacturing company executive. "My workers' compensation rates, unemployment insurance, and state business tax based on gross payroll together are pushing 20% of our payroll. These are three very substantial disincentives for hiring people. I have testified to the legislature that I could not understand how, in a state with the unemployment rate that Michigan has, they could possibly have laws that discourage hiring. And I haven't mentioned federal taxes at all—I'm just talking about state policies.

"Now we are making some headway because of the energy that was developed in the White House Conference on Small Business. We have substantially speeded up the organization of small business interests in Michigan.

"I preach the gospel that small business not only can run the state, but *should* run it, because it represents the most general interest group that you can possibly identify. We are laborers, consumers, and business all rolled into one. You can't name any other recognizable group with that breadth of perspective."—*R. Dale Moretz, vice-president, Mid-American Products Inc., Jackson, Mich., precision molders of thermoplastic materials, with about $2 million in sales and 36 employees.*

Accountant. "Until 1979, we had tax credits for investment in machines and for investment in people. We still give credits for investment in machines, many of which displace people. But we no longer give credits for investment in people, except for the Targeted Jobs Tax Credit, which hasn't amounted to much.

"We have been astonished to read of the companies vying to purchase an unnamed corporation that was going to require $5 billion to $6 billion of debt. How much of the interest on that debt would be deductible? Every cent. And yet, when interest rates were approximately 20%, a businessman wishing to borrow $50,000 at the bank to invest in his business would have had some of his interest disallowed."—*William Barth, director of small business practice for Arthur Andersen & Co., a big-8 accounting firm based in Chicago.*

Subscriber. "The government should eliminate tax breaks that are economically possible only to large corporations because of legal and accounting requirements. It should also eliminate taxes on a corporation's first $500,000 in profit. This could allow reinvestment and create jobs."

Subscriber. "We need a simple way to report the tax we owe. The average businessman can look at his checkbook, accounts payable and receivable, etc., and have a good idea of where he is financially. Yet we spend thousands of dollars each year for CPAs, computers, accounting, etc., just so we can defend ourselves against the Internal Revenue Service and various state tax people in the event of an audit."

Subscriber. "We are a *wee* company. Like thousands of companies, we're too small for everything but taxes."

Rick Friedman

William B. Anderson, president, Matrix Inc., East Providence, R.I.

PRICES AND INFLATION

Inflation has been overshadowed as business enemy number one during the past year. But it still weighs heavily on the minds of small businesspeople. The *ability to pass price increases on to customers* follows close on the heels of interest rates and overall economic growth to tie for their third most important concern in 1982 (see table 1). Three more price issues—wage costs, energy costs, and raw materials costs—rank among the top concerns of small businesses.

Large firms mention the inflation problem more often than small ones—the weighted score for this item ranges from 49 points for the $50-million-plus sales group down to 36 points for the under $500,000 group. The reason is probably that large companies keep better track of their costs and understand more clearly how inflation filters down to their bottom line. Small companies are notoriously poor at this. Some drive their competitors crazy with unrealistically low prices, as several of our forum participants lamented.

Subscriber. "Inflation must be controlled to reduce interest rates. If that means delaying or reducing the tax cuts, I feel it should be done."

Subscriber. "The tight monetary policies of the Federal Reserve Board are encouraging inflation rather than stopping it. High interest rates mean high production costs, which are passed on to the consumers as higher prices."

Economist. "The reason that high interest rates hurt is the same reason that high energy costs hurt, and that increased labor taxes hurt: We cannot get them passed on, so bottom lines are getting squeezed.

"A lot of things are going to keep interest rates high, while all of a sudden inflation has really slowed down. When that happens, the price of what you sell doesn't go up as fast. Two years ago, when inflation was high, you could handle a 15% interest rate easily because you could cover the costs. When the rate of inflation goes down, interest costs fall right to the bottom line.

"But I think you have to put this in perspective. I called around to CPA firms to find out how big interest expense is, relative to lots of other expenses among small businesses. It's not very large—1% or 2% of sales on average. That's double what it was a year earlier—but if we are worried about bottom line relief or cash flow relief, then a reduction in labor costs of a couple of percent, whether from taxes or whatever, will give more relief than a halving of interest rates."—*William C. Dunkelberg, professor of economics at Purdue University, Lafayette, Ind.*

Distributor. "I have been fighting for a lot of years to upgrade the management of welding supply distributors. In the National Welding Supply Assn., I tried to get them to realize what their costs are.

"We realize what our costs are. That makes us a leader in pricing, which creates an umbrella for the people who don't realize what their costs are to come in. The overall effect is to depress what the realistic price should be for the product. Now, with the instability in the marketplace, the competitors are reducing our gross margin."—*Craig Hosterman, chairman, Arizona Welding Equipment Co., Phoenix.*

Manufacturing company president. "The most critical thing today to small businessmen is the fear of inflation. That's why we have grasped onto the President's plan. Yet, so quickly do we lose sight of our prime concern. All of a sudden everyone is in a hysteria about interest rates and will do anything to get them lower again. The inflation rate is coming down, and as long as it does, we have to put up with this."—*William B. Anderson, president, Matrix Inc., East Providence, R.I., manufacturer of custom plastic components for the electrical transmission industry, with about $5 million a year in sales and 65 employees.*

Trucking company president. "All our drivers know that when the interest rate fluctuates half of a percent, it costs us $30,000 a year. We pounded that figure into them. We post our P&L every month. Three other executives and I run an orientation on the P&L, safety, or something else, every week at every single plant.

"Our goal is to make every employee understand why we can't cut some rates. They come to us when they lose an account, and we don't just say, 'Somebody undercut our rates.' We take the time to sit down and show what this guy is doing, what turbulence we are going through in the industry.

"You can get almost any rate you want today in trucking. We take the position that we perform a premium service and will charge a rate that allows us to stay in business. You've got to price your product where you've got a profit, and a big element in that profit now is the interest rate you're paying."—*John A. Pifer, president, Best-Way Transportation, Phoenix, a common carrier serving the Southwest, with about $20 million in sales in 1981 and 400 employees.*

Economist. "In 1980, the consumer price index rose 13.5%. In 1981, it's about 10.4%. The consensus of my group of economists is that for 1982 we'll be down to 8.3%. That's real progress.

"For the long run, they are saying that the average inflation rate over the next five years will be 8%. That's not great, but it's not bad. It's a lot better than 13%."—*Robert J. Eggert, president and chief economist, Eggert Economic Enterprises Inc., Sedona, Ariz., and editor of a newsletter that summarizes the forecasts of more than 40 leading economists.*

Manufacturing company president. "You have to be optimistic that Reagan's policies are going to control inflation. We raise our prices a lot of times in anticipation of what the inflation rate is going to be next year. That just creates a spiral for everybody."—*Don S. Stein, president, K-Tron International, Scottsdale, Ariz., manufacturer of industrial scales, with $21 million in annual sales and 350 employees.*

Subscriber. "My company will probably cease doing business this year. Without the ability to plan for future investment and expansion, being in business is nothing more than a crapshoot. The economy must be allowed to rid itself of devastating inflation psychology, and if my company is one of the casualties, so be it.

"I believe President Reagan is on the right track, but I also sense his inability to make changes in direction when it is needed. He appears to view a change in direction as weakness. I would counsel

Glenn Short

Nathan C. Collins, senior vice-president, Valley National Bank of Arizona.

Richard Mann

R. Dale Moretz, vice-president, Mid-American Products Inc., Jackson, Mich.

him to never say never and to always review the past."

REGIONS AND INDUSTRIES

Conventional wisdom has it that the country's "Frostbelt" is bearing the brunt of the economic slowdown, while the "Sunbelt" hardly feels it. According to INC.'s subscriber survey, that theory can be refined. We divided the United States into four regions: Northeast, Midwest, South, and West. As chart 5 illustrates, small businesses in the chilly Northeast and the balmy South reported very similar growth rates for sales, profits, and employment. The other two regions score as expected: the booming West on top, the industrial and agricultural Midwest in the cellar.

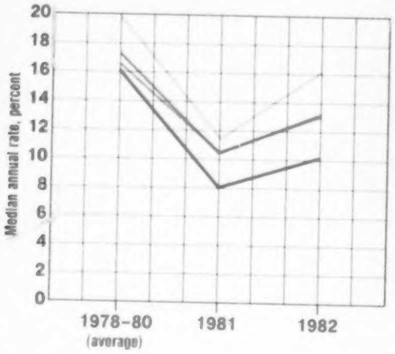
Since both sales and profits growth are distorted by inflation, the employment lines in chart 5 may afford the most accurate picture of small business's performance in this area. Small firms in western states reported median annual employment growth at a spectacular 7.6% during 1978–80. Or, compounded annually, employment grew 25% over the period. Median, of course, means that half of the firms exceeded that figure, while half fell below.

The other regions showed smaller but respectable gains for that period: the South, 6.4%; the Northeast, 5.2%; and the Midwest, 4.7%. Last year, though, the Midwest fell to almost zero, while the other three regions turned in figures between 2% and 3%. This year, firms in the West predict that annual employment growth will climb back to a 5.3% annual rate; the South and Northeast say they'll get a bit above 3%; and the Midwest sees itself attaining only 1.3%.

Chart 5: Small business growth by region

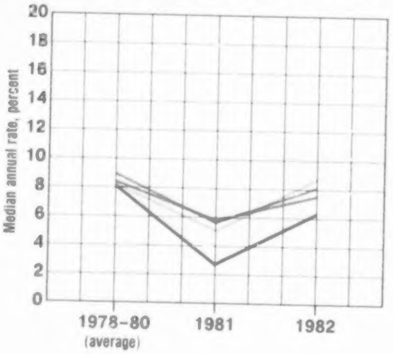
Sales

QUESTION: What is your firm's sales growth for: 1978–80 (average annual rate); 1981; your estimated rate for 1982?



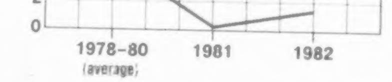
Profits

QUESTION: What is your firm's after-tax profits growth for: 1978–80 (average annual rate); 1981; your estimated rate for 1982?



Employment

QUESTION: What is your firm's employment growth for: 1978–80 (average annual rate); 1981; your estimated rate for 1982?



——— **Northeast** (Conn., Maine, Mass., N.H., N.J., N.Y., Pa., R.I., Vt.)

——— **Midwest** (Ill., Ind., Iowa, Kans., Mich., Minn., Mo., Nebr., N.Dak., Ohio, S.Dak., Wis.)

——— **South** (Ala., Ark., Del., D.C., Fla., Ga., Ky., La., Md., Miss., N.C., Okla., S.C., Tenn., Tex., Va., W.Va.)

——— **West** (Alaska, Ariz., Calif., Colo., Hawaii, Idaho, Mont., Nev., N.Mex., Oreg., Utah, Wash., Wyo.)

Rick Friedman

Shepard Lee, president, Lee Management Co., Auburn, Maine.

Other regional variations turned out as expected. The Northeast and Midwest, for example, give a stronger vote to energy costs as a concern for 1982 than the South and West do—30 points as opposed to 18, according to the weighting method used in table 1. Another telling difference, perhaps: Small midwestern firms award a somewhat higher score to state and local taxes—12 points—versus 6 or 7 for the other three regions.

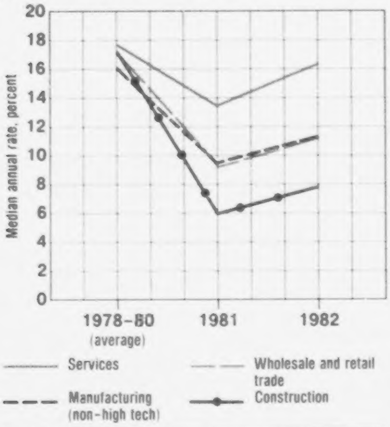
Also as expected, two industries show figures markedly different from all others: high technology, at the upper end of almost every scale, and construction, at the low end. With 35% of all firms reporting a significant modernization, capitalization, or improvement in 1981, for example, only 26% of companies in the construction industry did so, while 50% in high technology did. All will be down this year if the economy continues in its present condition: The proportion of high-technology firms saying they'll modernize falls to 37%, while in construction, the number is 16%, and for all industries together, the number is 23%.

Technology companies, though, are worrying a lot this year about competition from abroad, ranking that with interest and inflation concerns—far higher than any other industry or group puts it. Other manufacturing businesses accord special emphasis to raw materials costs. But for these standouts, most industries agree fairly closely with the overall ranking of priorities listed on table 1.

Chart 6 provides a hint as to which small businesses, besides those in the high-technology field, may prosper in the near future. Construction, wholesale trade, retail trade, manufacturing, and services all grew at about the same rate from 1978 to 1980. Not last year, though—and not this coming one, according to their own projections. While construction, trade, and manufacturing—making up more than one-half of the small business economy—dwindle, the service sec-

Chart 6: Sales growth in four small business sectors

QUESTION: What is your firm's sales growth for: 1978–80 (average annual rate); 1981; your estimated rate for 1982?



tor—another third—remains surprisingly strong.

LABOR

The national soul-searching about productivity is taking hold at the grass roots. Small business managers rate labor quality as surprisingly important in their agenda of economic concerns. In the ninth position, it falls just below credit markets, inflation, and economic growth as a major concern for 1982 (see table 1). Thus it's ahead of oft-heard gripes about taxes and government regulation—federal, state, and local. There's no discernible difference between the way large and small firms rated this concern.

This new preoccupation also manifested itself in the discussions at INC.'s 1982 outlook forums, where several participants described their efforts to elevate labor productivity.

The subject that usually comes to mind when anyone says "labor" is unions. Not to our sample of small businesspeople: Union activity is at the bottom of their list of headaches. Not even for the largest companies in our sample—the 4% who have sales above $50 million a year—do unions figure prominently.

Manufacturing company president. "For the first time in our company we are not increasing our wages. We are holding those who normally receive 8% or 10% increases to 5% this year, and we're reducing bonuses. In fact, I have talked to small, family-oriented businesses that are cutting wages.

"I found that I have five or six very well-paid professionals whose wages go up every year, and I could probably go out and replace them in the current market for 60% of what I'm paying them. Our profits are getting strained, so I'm saying I can't afford it anymore."—*William B. Anderson, president, Matrix Inc., East Providence, R.I., manufacturer of custom plastic components for the electrical transmission industry, with about $5 million a year in sales and 65 employees.*

Distribution company president. "We started out in 1936 as a retail laundry. Three years ago we decided to get out of the laundry business because it was our least profitable and most labor-intensive area, and it was in a declining industry. But I didn't have the guts to say I was going to lay off 35 people. There's a lot of emotion tied up in my business.

"So we decided instead to expand the laundry division, in association with the health-care industry. We see the hospital as being an integrated customer—over a time we can pick up one service, then another. From a business point of view, it makes a lot of sense. I see about 100 jobs being added to our present staff of 50 over the next year. We'll probably grow from $2 million in sales to $4 million in the next two years."—*Joseph A. Williams, president, Arrow Services Inc., Chicago, a commercial/industrial laundry and a distributor of uniforms and paper products, with annual sales of about $2 million and 50 employees.*

Manufacturing company president. "Ten or 11 years ago I was sent on a trade mission to Japan by the Chicago Association of Commerce and Industry. I soon learned that I couldn't teach the Japanese anything, so I hired an interpreter and asked him to take me around to small companies making miscellaneous metal products. I learned some things from these small businessmen that I put into practice.

"What I learned was, number one, when you hire somebody, don't consider him an employee; consider him part of the family. You don't fire him or lay him off. How do you do that? You have to hire a minimum number of people. If you think you need 50, don't hire more than 40. When you get very busy, either work overtime or obtain temporary help.

"But the nucleus, the people you employ permanently, are told they will have their jobs as long as the company stays in business. As a result, you get a certain type of productivity out of them. The results are much better than I can get in any other operation."—*Allan Harris, president, Harris Hub Co., Harvey, Ill., a manufacturer of bed frames and miscellaneous metal products, with sales of $20 million and 200 employees.*

Trade association executive. "Manufacturers are going to pay for marketing services as the marketing service is done, rather than making the very definite investment in salaries and sales forces. That way, their sales cost is exact and definite on the piece of goods that goes out the door to the shipping dock. The use of manufacturers' agents is increasing 20% per year. Our membership is increasing at least by that."—*James J. Gibbons, president, Manufacturers' Agents National Assn. in Irvine, Calif.*

Construction company executive. "We are cutting back. About 60% of our business has been road building for federal or state agencies. The state of Illinois has the smallest road program in this fiscal year, in real dollars, that it has had in 20 years. The private sector is so far down in this part of Illinois that those sales have almost been cut in half. We had a payroll of over $300,000 that we'll probably cut by $125,000.

"The other factor affecting us is the labor problems we've had this year and the enormous inflationary settlements that took place in the construction trades. As a result, I think you're going to see a tremendous influx of small construction companies popping up, and a tremendous movement to nonunion construction in the state. A company like ours, which has always been a union company, will have to consider that. We would never have thought of doing that until now."—*John Holub, executive vice-president, Rockford Blacktop Construction Co., Rockford, Ill., with 400 employees.*

Economist. "Our task force found that, from 1975 to 1979, firms with 20 or fewer employees accounted for 56% of net employment added in the economy. We also found that much of that creation is concentrated in relatively few firms over a relatively short term. Most of the gain in employment was added in the firms' first two years.

"Clearly, a lot of the firms disappeared. To get one net new job among new firms, we found, about two new jobs have to be created just to take account of the loss. Among old firms roughly three jobs have to be created just to get one net new job.

"This suggests that an emphasis on creation of new firms and new jobs is very important. You lose jobs no matter where you are in the country or in the business cycle. The difference between areas that are growing and dynamic and those that are not is in the creation of new employment rather than the prevention of the loss of old."—*Michael Teitz, professor of city and regional planning, University of California at Berkeley, and a member of the Urban Small Business Employment Project of the state of California in 1980, speaking at an INC. 200 awards banquet in San Francisco, October 1981.*

This article contains selected results from INC.'s subscriber survey and comments by some participants in the three small business forums. For a complete summary of findings and a list of all the forum participants, write on your company letterhead to: Outlook Editor, INC. Magazine, 38 Commercial Wharf, Boston, MA 02110.

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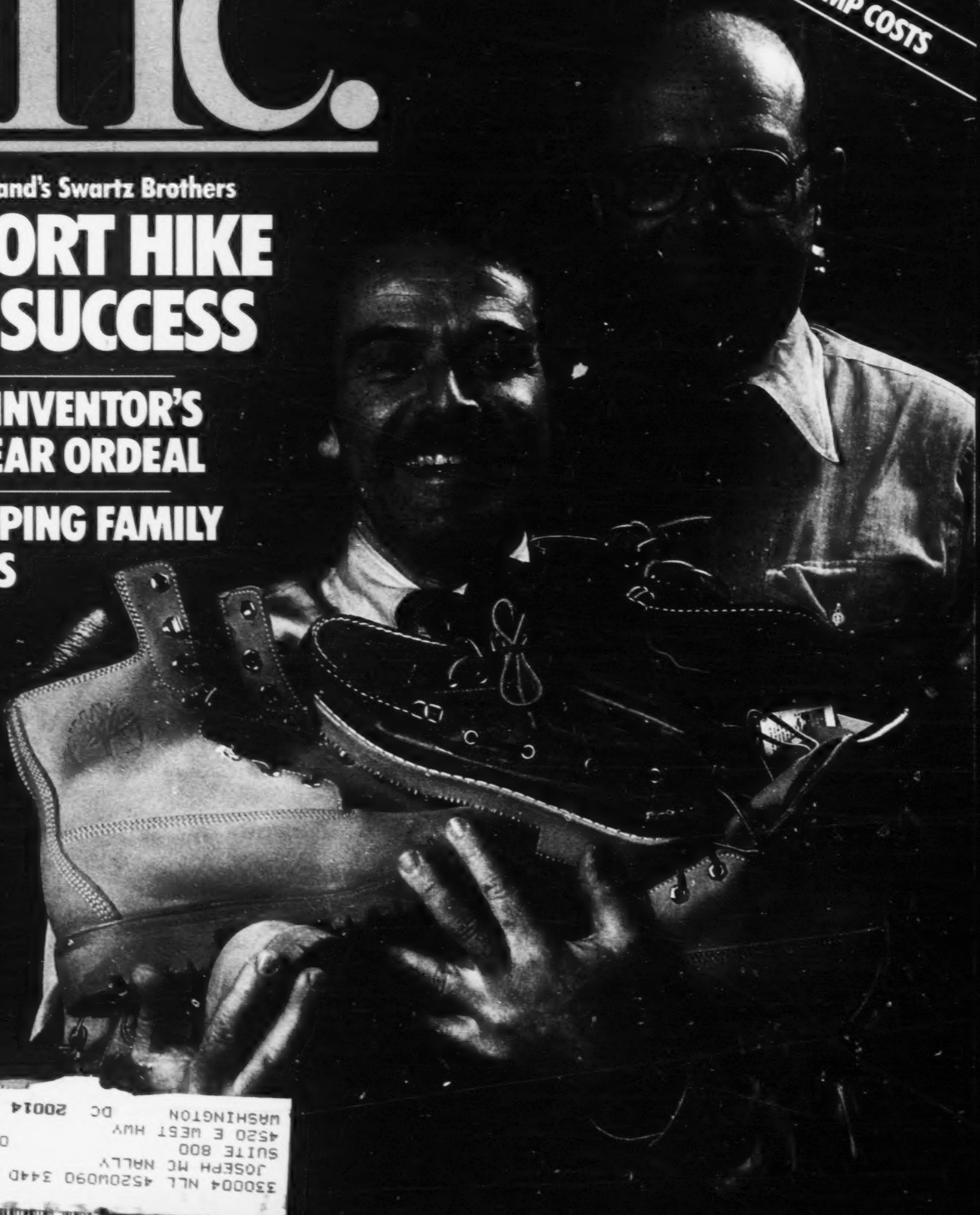

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By Tom Richman

CAN THE U.S. CHAMBER LEARN TO THINK SMALL?

Though 91% of its 230,000 members are small companies, the Chamber is still run by corporate fat cats.

The differences between large and small businesses are mostly imaginary, says U.S. Chamber of Commerce president Richard L. Lesher.

The U.S. Chamber of Commerce has always drawn its numbers from the ranks of small business. Its dollars, on the other hand, have come from the country's largest corporations. A mom-and-pop retail firm pays $100 to join the Chamber. The biggest companies are charged $75,000 or more. Dues for the average new member in 1981, according to Chamber figures, were $155.

It should surprise no one, then, that the heavyweight dues-payers—major corporation executives—hold most of the seats on the Chamber's board, and that the chairman of the board has always been a corporate mogul. In the last couple of years, however, small business members have begun to wake up. It is still true that, when the Chamber's board meets to ponder solemnly the future course of capitalism, the old corporate neckties are still worn. But now there is an irreverent small business commotion outside the boardroom door that won't be ignored.

One reason for the noise small business is making in the Chamber is the organization's phenomenal growth rate: Membership doubled in 1981 as 600 commissioned salespeople, reinforced by telephone solicitors, signed up new companies at the rate of 3,000 per week. The Chamber closed 1981 with about 215,000 members, almost halfway toward its goal of a half-million by the end of 1983.

As the Chamber gets bigger, its members get smaller. You can't recruit 100,000 new companies from the *Fortune* 500. Between April 13 and October 7, 1981, 69,000 firms joined the Chamber, and of those, 48,000, or nearly 70%, employed 10 or fewer people. The smallest companies, which in April made up 37% of the Chamber's total membership, by October accounted for 49%. In fact, 91% of the Chamber's member companies have fewer than 100 employees. The Chamber's membership is overwhelmingly small business—and getting more so.

The U.S. Chamber's membership comes closer than that of any other lobby to reflecting the diversity of the American business community. But the people who set policy for the Chamber—deciding which bills, which regulations, and which politicians the organization will support or oppose—don't reflect that diversity.

Small business membership on the Chamber's board has grown to as many as 10, if "small business" is very broadly defined. If you count only those members who head companies doing less than, say, $50 million annually, the number drops to 6 or fewer.

Eamonn McGeady, an active Chamber member who is president of a Baltimore marine construction firm, says, "The big boys on the board just don't trust the little boys. They might do something rash." Indeed, one board member confides that "it would be embarrassing" to have "unsophisticated" small businesspeople sitting on many of the board's policy committees.

(continued on page 82)

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"I'm a small businessman."
-John Havlicek

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But McGeady sees the Chamber's emerging small business activists as "generally well educated if not well-heeled. They're not kooks. They are people who turn out to be socially acceptable. As these people earn their spurs within the organization," he says, "their performance will gradually impel them onto the board."

Chuck McDonald, president of McDonald Equipment Co. in Willoughby, Ohio, and a member of the Chamber's Council of Small Business, agrees. "You'll find that the small business voice in the Chamber will be stronger," he says. "It won't be the only voice, but that's as it should be."

Like the membership of the board, the structure of the Chamber's staff also fails to reflect the overwhelming small business membership of the organization. But here, too, change—slow change—is under way.

The U.S. Chamber's 400-plus-member Washington staff consists of a president, one senior vice-president, at least seven vice-presidents, three general managers, 21 managers, 63 directors, and various controllers, associate directors, special assistants, counsels, and others. Most of them work in a large stone building across the street from the White House, the inside of which is indistinguishable from dozens of government office buildings housing equally inscrutable bureaucracies. Interoffice memos sometimes take two days to get where they're going. It's the kind of organization in which executive-level bureaucrats have their secretaries telephone, then leave you dangling on hold until the boss picks up.

"They told me when I came here," says Jeff Joseph, manager of the Business-Government Affairs Division, "that it would be six months before I thought I understood how this place works and a year before I would know that I still didn't understand it."

One of those 63 staff directors, Ivan Elmer, heads the Chamber's four-person Small Business Center. It sits on an organizational tier three levels below the president's office. Elmer, a 16-year Chamber veteran, "is a gentleman and is capable, but he's an organization man who wants to stay that way," says a member who works closely with him.

Until 1976, when Elmer was put in charge of developing the just-created Small Business Center, there had been no official recognition within the Chamber's staff structure of any need to think of small business as distinct from all business. Five years later the Center remains one small part of the huge bureaucratic structure, but Chamber staffers say it's become an important base to touch. "Issue managers call me frequently to check on the small business impact of lots of issues," says Chris Russell, a congressional lobbyist for the Center.

The lay counterpart to the staff Small Business Center is the 60-member Council of Small Business, one of 18 policy committees that report to the board. Committees are headed by board members, but not all committee members hold board seats.

The council meets twice a year to vote on policy recommendations that are based on research data and information provided by Chamber staff. Those recommendations eventually get to the board, either directly or modified first by one or more of the Chamber's 17 other policy committees.

So if there's one place in the U.S. Chamber where small business activism should blossom, the council is it. Look hard and you can find the bud, but there's little bloom yet. "When we have brought up items that would make the board of directors uncomfortable, we've been asked not to pursue them," says Elaine Donaldson, executive vice-president of Donkirk Tool Supply Inc. in Convina, Calif. For example, some council members say their attempts to talk about problems created by high interest rates were discouraged, because the Chamber board strongly supports the government's tight monetary policy.

Council members seem to fall into one of two groups, Company Men and Young Turks. Frank Morsani, the chairman of the council, is definitely a Company Man. Other council members call him Father Morsani. He owns seven auto dealerships, selling mostly foreign cars, in Florida, Kentucky, and Georgia. He's a mediator who does his best to defuse confrontation. "Individual council members," he says, "will want things that the board wouldn't approve. I try to be sure we have winnable issues." Morsani sits on the Chamber board.

So does Van P. Smith, another council member, whose business interests and holdings include several industrial firms, an industrial park, a television station, and an interest in a bank. Smith, from Muncie, Ind., is also a Company Man and sees the Chamber as an "umbrella group that speaks to the needs of the entire business community." Let other organizations represent the special needs of small business and specific industries, he says; the Chamber's role is to help set broad economic directions. "Our first job," Smith holds, "is to see that the train is going in the right direction. Then you can put the windows up or down."

"Frank Morsani, Van Smith," says Chamber member Jack Yaissle, "hell, those aren't small businesspeople as far as I'm concerned." Yaissle's family-owned Pottsville, Pa., auto and truck body shop employs 15 people plus Yaissle's wife, who runs the office. A

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member of the Small Business Council, Yaissle acknowledges the progress the council has made in raising the Chamber's small business consciousness, but says the Chamber is still skewed toward big business because "Big Daddy pays the bills." He complains that the Chamber could do something—but doesn't—to help small companies live through this period of high interest rates. "There is no leadership from the Chamber in most important small business issues," he says.

Another of the council's Young Turks, Bill Nourse, runs a hardware store in Nashville, Tenn. Of all the Chamber committees, he says, the Small Business Council is "the most active but probably has the least impact. I don't think upper Chamber management takes us seriously yet."

Yaissle and Nourse, like many of the other Young Turks, are active in other small business organizations, some of which take stands in opposition to the Chamber. But whatever their complaints, this council faction is sticking with the Chamber. "They've got the resources," says Nourse, "and we've got to find a way to channel them."

Those resources are, to say the least, substantial. In the fiscal year ending June 30, the Chamber expects to collect $57 million in dues, up from $28 million last year. Subscription and advertising revenues from its publications and radio and TV programming will contribute $21 million. Altogether, the Chamber anticipates income of $85.6 million this year, a 35% jump over 1981. While nearly $32 million will be plowed right back into marketing and sales, a nifty $50-million-plus will be available to promote the Chamber's mission: "To advance human progress through an economic, political, and social system based on individual freedom, incentive, initiative, opportunity, and responsibility."

Admirers and detractors alike acknowledge the U.S. Chamber's ability to influence public opinion, in turn influencing thinking in Washington. Every week the Chamber mails a hefty tabloid newspaper, *Washington Report*, to 887,000 subscribers. The circulation of its monthly magazine, *Nation's Business*, is more than 1.1 million, larger than that of *Fortune*, *Forbes*, INC., or *Business Week*. About 1.3 million households, according to Chamber figures, watch its weekly half-hour television program, "It's Your Business."

The Chamber has just completed filling the courtyard of its Washington office building with the largest (by their estimate) television studio in the city. And it's building a private satellite television network, called BizNet, that will link Chamber headquarters with state and local chambers, corporations, and any member who wants to install a receiving dish. Also down the road is a daily, half-hour business news program for commercial television.

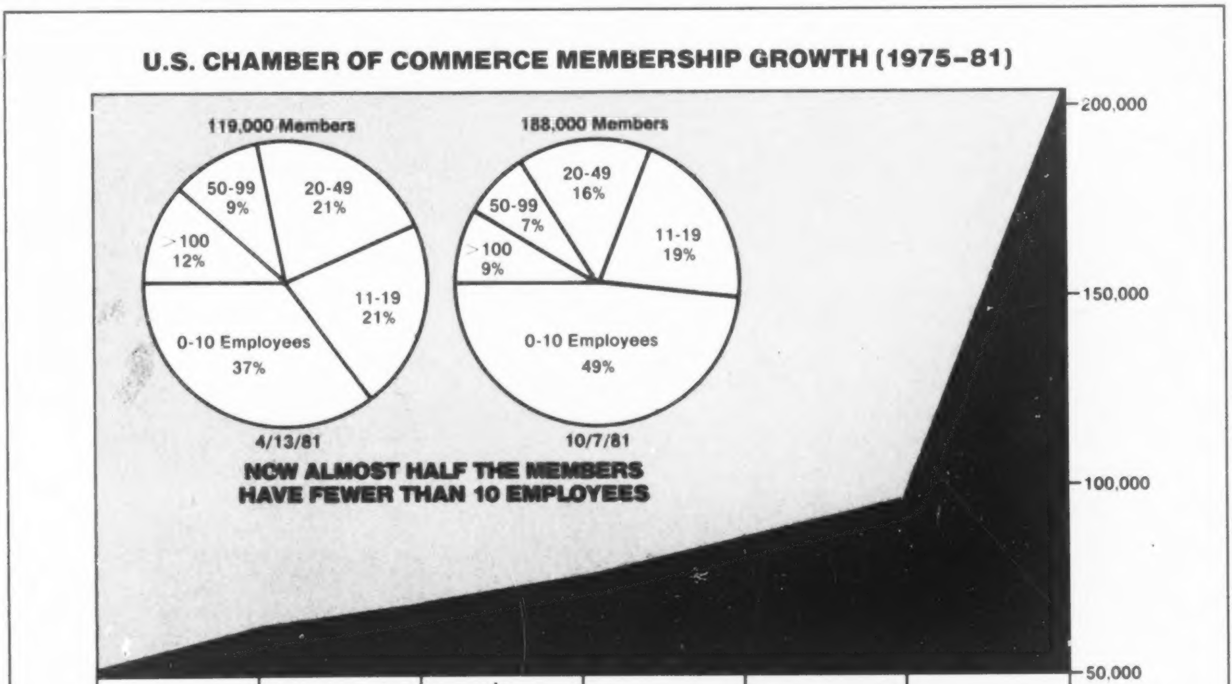
And every day the Chamber staff cranks out news releases, editorials, study reports, speeches, etc., that it mails to the media and to member organizations. "What this organization really is," says Chamber president Richard Lesher, "is a communications conglomerate."

Despite the lopsidedness of its board and committee structure, over the past several years the Chamber has generally used its resources in support of legislation favored by more narrowly based small business lobbies. It worked hard in 1980 to enact the Regulatory Flexibility Act, for example, and it continues to be one of the strongest proponents of regulatory relief for small companies.

Last year the Chamber's board bent its standing policy of opposition to quotas or set-asides in government programs to endorse legislation calling for small business set-asides in government-funded research and development.

A staff aide to the House Small Business Committee didn't ask the Chamber to testify publicly in support of that legislation because, in his words, "The Chamber doesn't represent small business." But the same staffer later asked Chamber lobbyists privately to help him find House members who would agree to add their names to the bill as cosponsors.

In the competition between the Reagan Administration and House Democrats to write last year's tax bill, the Chamber sided solidly with Reagan. ("We like to think Reagan adopted our program," says a senior Chamber executive.) That provoked criticism from some members and from some small business lobbies who saw the Democrats' bill as more favorable to small business. While it is unarguably true that the original Reagan plan contained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little of specific interest to small business, the White House eventually had to make concessions to push the measure through Congress. "When it came time to compromise," says Wayne Valis, a White House special assistant, "we negotiated with our friends." Few groups had been friendlier than the U.S. Chamber, to whom Valis gives much of the credit for seeing that reduced corporate tax rates, liberalized estate and gift taxes, and other cuts of specific interest to small business were incorporated in the compromise bill.

In spite of the Chamber's recent record of support for small business, skeptics on Capitol Hill, on Main Street, and even inside the Chamber itself believe that it is still an organization run by and dedicated to the welfare of the fattest of America's corporate cats.

Sometimes, the Chamber's own rhetoric fuels this view. Last summer, in one of his frequent mailings to editors, Chamber president Richard L. Lesher said that Reagan's tax bill "has touched off a series of questions and controversies over who will reap the greatest share of its benefits. . . . Will big business benefit while smaller companies suffer?" Lesher dismissed such concerns as "missing the point," which was, he said that the Reagan plan would help everyone.

"I really think," says Lesher, "the dichotomy between big business and small business is imaginary more often than not. It's a dichotomy that often the opponents of the business viewpoint like to conjure up. They like to divide and conquer."

The increasing dominance of small business in the Chamber's membership does not cause Lesher to "see any major changes in the way we construct our policies." Nor has it caused any further change in the Chamber's most visible body, its board. New members added last year included the chief executive officers of 3M, Safeway Stores, R.J. Reynolds Industries, and the president of Stokely-Van Camp.

"Well," says Lesher, "I think you'll find that in the year 3000 small businessmen will still be dissatisfied with whether or not their voices are heard in Washington. But for those businesses, small or large, that are interested in being part of an advocacy organization that has the critical mass, the resources, the momentum, and a broad-based program for impacting on Washington, this is the place to be." □

Editors note: This is the first in a series of articles focusing on small business organizations and how responsive they are to their constituents.

Tom Richman is Washington editor for INC.

WHO THE IRS AUDITS

Unfortunately, the very things that encourage the IRS to audit you are the things that—for your own reasons—you're likely to want on your tax return.

By Irving L. Blackman

Soon millions of taxpayers will be filing their 1981 tax returns. Hands down, the most common question at this time of year is, "Will the IRS audit my tax return?"

The answer is that your chances of being audited depend on many factors, including Lady Luck. The higher your income, the greater your chances. Increasing deductions in relation to income also brings the long arm of the examiner closer.

The Internal Revenue Service indicated in a recent report that a computer picks most returns that are audited. The computer gives each return a score by assigning numerical weights to items on the tax return. The precise items and weights, unfortunately, are a closely guarded secret. But the higher your score, the better your chances of an audit.

No one has figured out how to crack the computer program, but we do know that unwelcome points are scored if your deductions are out of line. (See box for the latest national average deduction figures based on 1979 returns.) Keeping close to the national average, however, doesn't free you from the obligation of maintaining good records to document your deductions.

AVERAGE DEDUCTIONS CLAIMED IN 1979

Adjusted gross income	Contributions	Interest	Taxes	Medical
$20,000–$25,000	$ 583	$ 2,589	$ 1,699	$ 590
25,000– 30,000	654	2,792	2,053	549
30,000– 40,000	795	3,110	2,526	518
40,000– 50,000	1,115	3,069	3,327	514
50,000– 100,000	1,793	5,131	3,675	696
100,000 or more	8,958	11,896	13,409	1,223

You may also want to consider the following list of audit triggers that the staff of the tax and legal publisher Matthew Bender believe to be the top 10 for personal returns:

1. Total gross revenue of $100,000 or more, or a substantial loss, from a proprietorship or partnership.
2. Total income before tax shelter activity of $50,000 or more.
3. Tax shelter activity.
4. Preparation of the return by a preparer on the IRS's list of "problem preparers."
5. Travel and entertainment expenses.
6. Business automobile expenses.
7. Casualty losses.
8. Significant barter income. (Note that failing to report any of your barter income won't necessarily keep you safe. The IRS has a "barter project" for investigating deals that are not reported.)
9. Home office deductions.
10. Losses incurred in "businesses" that seem to be hobbies.

If you do get audited, you have a new incentive to settle quickly this year. Starting February 1, the IRS will be charging 20% interest on taxes it concludes you owe.

The current interest rate is 12%. The new rate was set in accordance with last year's Economic Recovery Tax Act, which requires the IRS to establish a rate every year equal to the prime rate charged by banks. When the rate was set for 1982, the prime was hovering around 20%. It doesn't matter that the prime has dropped since last fall; 20% is the rate that will be in force throughout the new year.

The IRS's new interest-rate policy can hurt you badly. Most audits take place a year or two after a return is filed. And fighting with the Internal Revenue Service can take four to six years or more. Thus a high IRS interest rate can easily mean you'll pay more in interest than the amount of the delinquent tax. The IRS has a substantial new advantage in negotiating with you.

There's just one bright spot. If it turns out that the IRS owes *you* money, the new policy means the government will be paying interest to you.

DON'T LOSE YOUR INTEREST DEDUCTION

Here's an interest tax trap you probably don't know about.

Suppose you owe the Nice Bank $20,000 for 90 days. The $1,000 interest comes due. The bank allows you to pay the interest and the old note by signing a new $21,000, 90-day note. According to the Internal Revenue Service, the $1,000 is not deductible. "Why?" you scream. Because the IRS says the interest is not really being paid if you borrow the interest due from the original lender. Unfortunately, the Tax Court recently supported the IRS on this. (See *Battlestein* v. *IRS*, 47 AFTR 2d 81-390.)

Is there a way to avoid this? Yes. Borrow the $1,000 from a second lender to pay off Nice Bank. Then you will be meeting the requirements of the court by paying cash instead of increasing your debt to the original lender.

PREVENT THE TAX BITE ON SERIES "E" BONDS

Here is a neat little gimmick that can prevent taxes on all those Series "E" Savings Bonds that Aunt Martha gave your kids: At the end of each year, file a tax return for the child and *elect* to treat the year's increase in the bond's value as interest income.

In most cases, your child will be in a zero-tax bracket and the earnings will escape tax-free. If the child held the same bonds until they matured, without declaring the interest income every year, all the income would funnel onto his tax return at one time. By that time the child would probably be an adult in a bracket where the tax-man's bite would be painful. But since the income was "made taxable" by your election, when the bonds mature years later all the proceeds will be collected tax-free.

The principle and tax-free accumulations are nice to contemplate as your child grows up. ☐

Irving L. Blackman, a contributing editor of INC., *is a tax partner of Blackman, Kallick & Co., Chicago, Houston, and Miami.*

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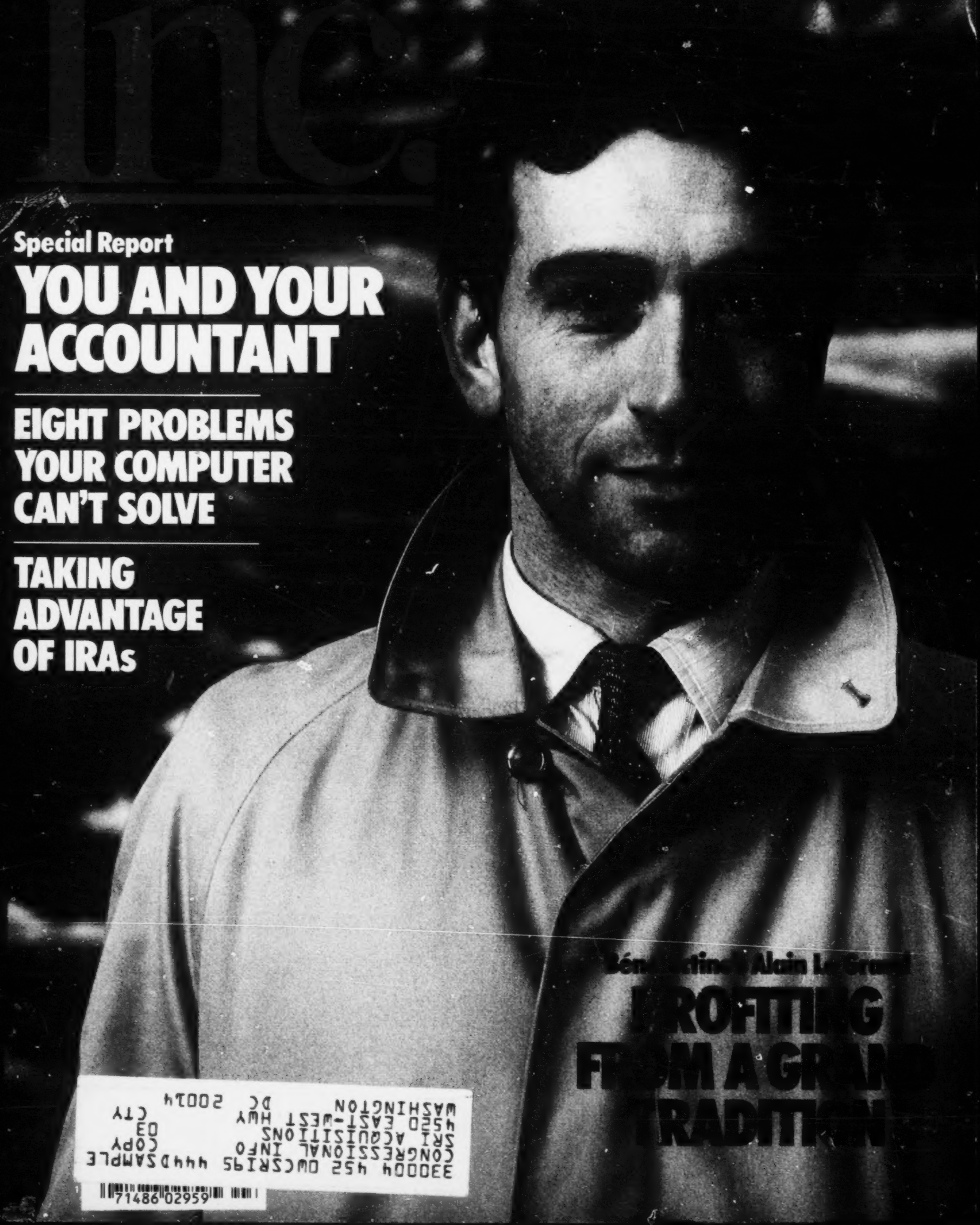

Special Report

YOU AND YOUR ACCOUNTANT

EIGHT PROBLEMS YOUR COMPUTER CAN'T SOLVE

TAKING ADVANTAGE OF IRAs

Bénédictine's Alain Le Grand

PROFITING FROM A GRAND TRADITION

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John Launois/Black Star

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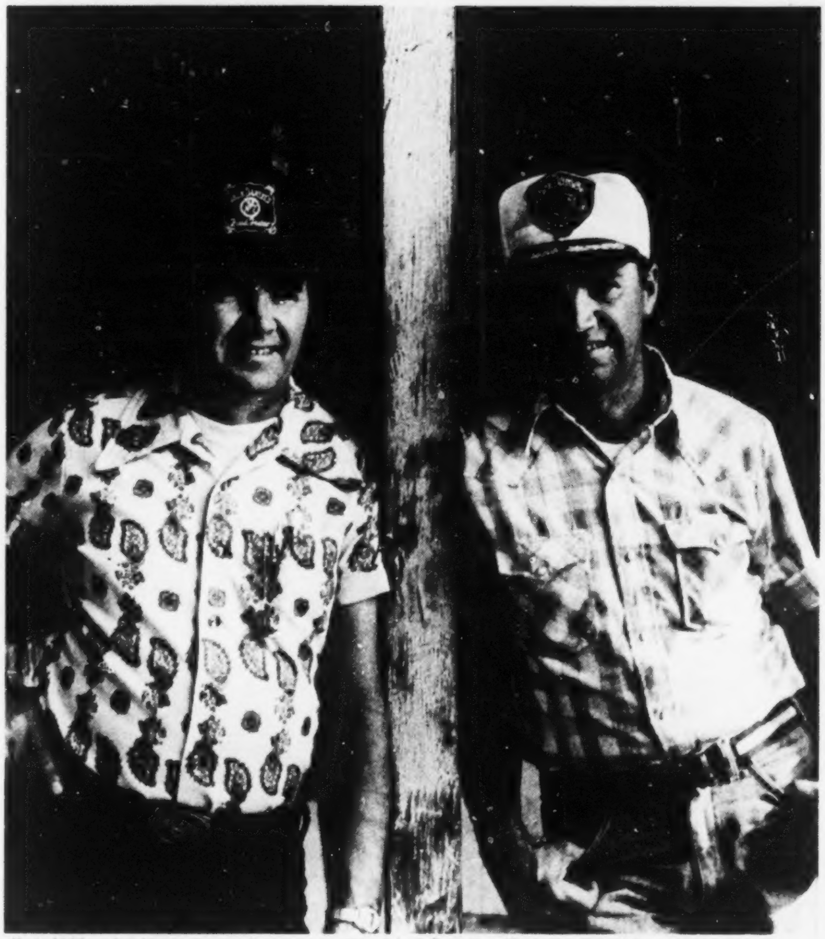
Cover photo
John Launois/Black Star



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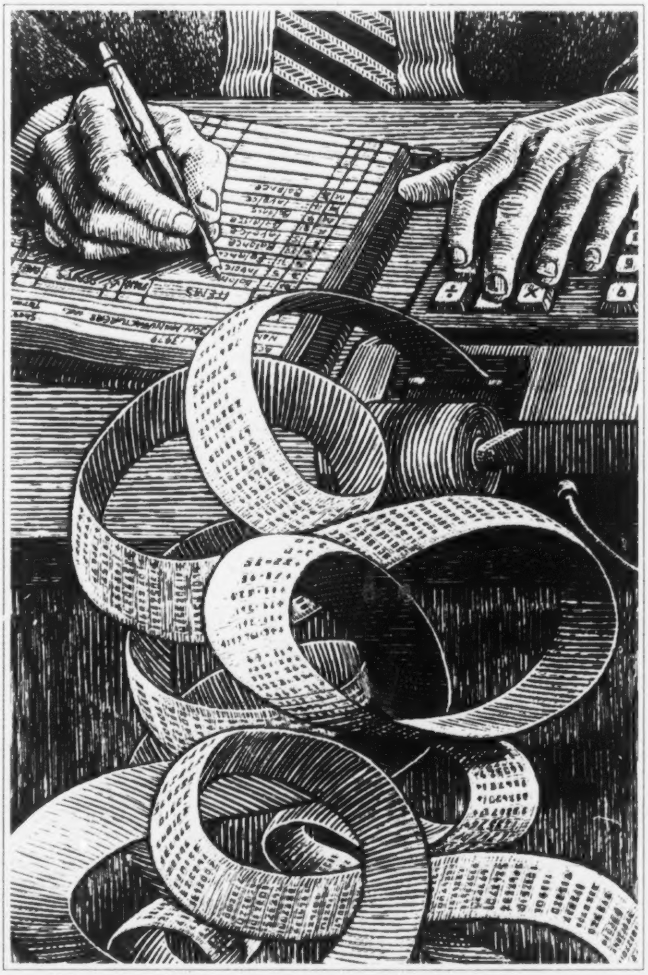
INC. Special Report

YOU AND YOUR ACCOUNTANT

How to evaluate the relationship between you and your company's most important adviser.

By Bradford W. Ketchum, Jr.



The public accountant is a powerful force. The quality of his advice directly affects a company's taxes, its balance sheets, and even its management decisions. Yet many small business executives find it difficult to work with accountants since their own backgrounds are more likely to be in sales, engineering, or research. More than two out of three (69%) of the chief executives surveyed by INC., for example, have no finance or accounting background.

As a result, many small businesses find public accountants somewhat intimidating, regarding them as outsiders who serve as buffers against an even more intimidating Internal Revenue Service. At best, the public accountant is considered an impartial paper-pusher who comes in periodically to wrestle with the company's books at a borrowed desk.

But an increasing number of small businesses view their outside accountants in a different role. Asked to identify their No. 1 advisers, for example, more than half of the respondents to INC.'s study cited their public accountants. Many of these companies have established a working relationship in which the accountant is an indispensable sounding board and business counselor. In short, their accountants not only review the books and compute taxes, but also provide crucial advice on such matters as cash flow, credit, cost control, and systems management.

To help small companies evaluate and improve their rapport with accounting professionals, INC. surveyed more than 5,000 small business executives and over 2,000 public accountants (see box). The results of the study are summarized in the following eight-point checklist and accompanying tables.

1. How big should your own staff be? Most small companies have limited inhouse accounting staffs. The majority of those with sales of less than $1 million employ only one person in a bookkeeping or accounting function. Those with sales of up to $5 million generally employ only two or three in accounting, and the number jumps to five or six as company size grows toward $25 million. Only in companies with sales of more than $25 million is the in-house accounting staff likely to exceed half a dozen employees. Furthermore, in two out of three companies surveyed by INC., the chief executive also doubles as the chief financial officer. Only among companies with sales of more than $5 million does the majority have full-time chief financial officers. In these cases, the top financial manager is generally a vice-president, treasurer, or controller heading an accounting staff.

Whether it consists of one person or half a dozen people, your internal staff is a vital link between your business and its outside accountants. While any decision about your accounting firm is up to top management, it is one that should not be made without consulting your staff, which may have different insights into the technical competence and personal chemistry necessary for a productive relationship. Does your staff feel free to call the company accountant with questions? Do they receive a ready response, and does the advice work? How often has your outside accountant shown your staff how to streamline its paperwork? Does the accountant take the time to make sure your staff understands the finer points in a company statement? Answers to such questions represent the first step in eval-

Illustrations by Doug Smith

uating your outside accounting firm.

2. What should your public accountant be telling you? Some 51% of the respondents to INC.'s survey regard their public accountants as their chief outside advisers (followed by their attorneys and bankers). Preparation of tax returns and financial statements may be your accountant's primary responsibility, but it should not be his only duty. The documents he prepares should satisfy Uncle Sam's requirements, but they should also be treated as financial tools that meet management's needs.

Besides combing your books, your accountant should monitor your business and suggest alternatives for controlling costs and improving profits. In short, he should serve not as a part-time manager but as a full-time adviser to management.

The recent changes in the tax law provide a good test of your accountant's technical competence and ability to keep you advised. Chances are your accountant has mentioned the Economic Recovery Tax Act of 1981, but has he fully explained its impact on your business? The sweeping revisions in the tax law may or may not affect your 1981 return, but they're guaranteed to have an impact on your business taxes this year and for at least six years to come. While the new rules governing depreciation schedules and investment credits may not be important to you, your accountant should be filling you in on other revisions ranging from the modest cuts in corporate tax rates to the new rules governing estate and gift taxes.

Understandably, the impact of the 1981 tax law is currently the chief topic of discussion between small business executives and their public accountants. Close to half (49%) of the respondents to INC.'s survey cited the tax act as a matter on which they have recently received accounting advice. Other key concerns include state and local tax laws, reporting rules, employee retirement programs, estate planning, and inventory valuation.

Top management apparently keeps business and personal matters separate, however. Less than 1% of the respondents noted that they rely on the company's

THE INSIDE STORY

How in-house staff size relates to annual sales, fees paid, and type of accounting firm used.

	No. on internal accounting staff								
	0	1	2	3	4	5	6	7-10	11+
Annual Company Sales	Percent of respondents								
Under $1 million	13%	55%	22%	5%	2%	1%	–	1%	1%
$1 million–$2.9 million	3	27	40	17	8	3	–	1	1
$3 million–$4.9 million	6	14	32	23	13	5	2	5	–
$5 million–$24.9 million	4	7	13	17	11	13	13	11	11
$25 million or more	8	–	3	–	6	8	9	23	43
Percent of all respondents	8%	32	25	13	7	4	3	4	4

	No. on internal accounting staff								
	0	1	2	3	4	5	6	7-10	11+
Annual fee paid to outside firm	Percent of respondents								
Under $1,000	15%	56%	22%	7%	–	–	–	–	–
$1,000–$5,000	8	42	31	10	6	1	1	1	–
$5,000+	5	17	21	18	9	8	6	8	8

	No. on internal accounting staff								
	0	1	2	3	4	5	6	7-10	11+
Type of accounting firm used	Percent of respondents								
Sole practitioner	9%	43%	27%	8%	7%	3%	1%	1%	1%
Local	8	34	25	14	8	3	2	4	2
Regional	6	30	29	16	5	4	4	3	3
National	2	19	29	16	6	6	6	8	8
Big Eight	5	9	17	11	7	12	7	10	22

Most small companies with annual sales of less than $5 million employ internal accounting staffs of 3 or less, while larger company staffs range from 6 to 16. Companies with smaller accounting staffs also spend less for outside services and are more likely to employ sole practitioners or local firms than regional or national accounting firms.

HOW ACCOUNTANTS LOOK AT SMALL BUSINESS

Typical client (annual sales $)	Type of accounting firm				
	Sole prac.	Local	Reg'l.	Nat'l.	Big Eight
	Percent of respondents				
Under 100,000	4%	1%	0%	0%	0%
100,000-499,999	22	16	14	0	0
500,000-999,000	34	29	14	0	0
1 mil.-1.9 mil.	17	21	21	30	6
2 mil.-4.9 mil.	18	20	15	20	18
5 mil. or more	5	13	36	50	76
Average ($ mil.)	$1.3	3.1	5.4	6.0	13.8

To most local accounting firms, "small business" means a company whose sales are less than $5 million. By contrast, most national and Big-Eight firms define small companies as those with sales of less than $20 million. The local accountants' small business clients average $3.1 million in sales; the Big Eight, $13.8 million.

public accountant for personal needs.

3. How often should you talk with your accountant? The answer: whenever the need arises. And for most small businesses that's no more than once a month. While one out of three small companies is in touch with its accounting firm on a weekly basis, most of them talk with their public accountants about every four to six weeks. Among respondents to the INC. survey, 57% report 30 days or more between contacts, with the average frequency running 39 days.

Although lack of communication is a source of dissatisfaction among small businesses, less than 1% of the survey participants cited availability of the accountant as a problem. The more important question, therefore, is how often your accountant should talk with you. If the communication is always a one-way street, it's time to evaluate the entire relationship.

4. What type of accounting firm do you need? The accounting profession suffers from what can only be described as "Big-Eight syndrome," a disorder that suggests bigger means better. Fortunately, it's not necessarily contagious. While the prestige of a multinational public accountant may impress your banker and attorney, the horsepower and expense that such services represent may be impossible to justify. Size is important only to the extent that it represents sufficient staff to meet your needs.

More than half of the companies said public accountants were their No. 1 advisers.

If your sales have topped $25 million, if your accounting needs are highly complex, or if you're moving toward public ownership, a national or Big-Eight accounting firm may be the best bet. Otherwise, smaller companies generally stick with smaller accounting firms.

The majority (56%) of the respondents to INC.'s study deal with sole practitioners or local accountants. Another 26% rely on regional accounting firms. Only 18% indicate use of a national or Big-Eight organization. Not surprisingly, the last group of respondents includes 80% of the companies with sales of $25 million or more. But it also represents a sprinkling of companies with sales of less than $5 million and even a few whose sales are under $1 million. Such figures testify to the inroads being made by accounting's giants.

All of the Big Eight now boast separate small business staffs. Overall, half of the national firms responding indicated

HOW—AND HOW MUCH—ACCOUNTANTS ARE PAID

	How Accountants Are Paid				
	Hourly	Flat fee	Retainer	Negotiated fee	Other
Annual company sales	Percent of respondents				
Under $1 million	63%	30%	7%	2%	2%
$1 million–$2.9 million	58	35	7	2	2
$3 million–$4.9 million	63	29	11	3	4
$5 million–$24.9 million	64	25	10	7	2
$25 million +	52	18	12	21	–
Percent of all respondents	61%	30%	9%	4%	2%

	How Much Accountants Are Paid						
	Under $1,000	$1,000-$2,999	$3,000-$4,999	$5,000-$9,999	$10,000 $19,999	Over $20,000	Average annual fee
Annual company sales	Percent of respondents						
Under $1 million	22%	44%	16%	12%	5%	1%	$3,000
$1 million–$2.9 million	6	28	25	25	14	2	$5,300
$3 million–$4.9 million	1	13	28	29	19	14	$10,600
$5 million–$24.9 million	1	7	7	19	33	33	$16,600
$25 million +	–	–	–	7	11	82	$42,600

Regardless of company size, the majority of smaller businesses pay their public accountants by the hour. The larger the business, the bigger the tab. Among the smallest companies, the annual accounting bill averages $3,000, while the largest firms incur accounting fees that top $42,000.

PICKING AN OUTSIDE ACCOUNTANT

Types of firms used, and how they're chosen

Type of accounting firm used	Percent of respondents
Sole practitioner	16%
Local	40
Regional	26
National (other than Big Eight)	8
Big Eight	10
Top 10 factors*	
1. Personal contact	41
2. Reputation	36
3. Prior relationship	25
4. Recommended by banker or attorney	21
5. Recommended by other clients	16
6. Location	13
7. Range of services	12
8. Industry expertise	9
9. Fee	7
10. Small business's parent company	3

**Total exceeds 100% due to multiple responses*

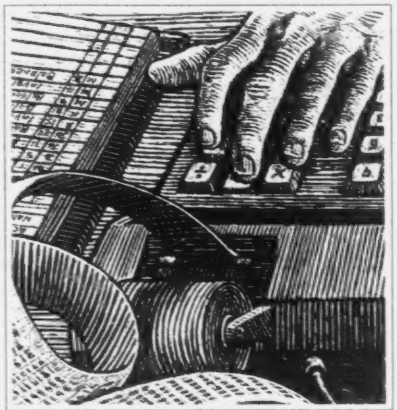
Although 18% of smaller companies surveyed retain national or Big-Eight accounting firms, the majority (56%) rely on either sole practitioners or local firms. The two biggest influences on small business's choice of public accountants are personal contact and reputation of the firm.

that they offer discrete small business advisory services. Among the national accountants, the average small business client is a company with sales of $6 million, while among the Big Eight, the smaller client is more typically a company with sales of about $14 million.

Few local or regional accounting firms seem to have separate small business staffs within their organizations. Most of these firms consider themselves small business specialists to begin with: Four out of five of their clients are small companies, typically ranging in size from $1.3 million for sole practitioners to $5.4 million for regional accountants.

Boding well for small business and reflecting the intensified competition for small company clients, 94% of the accountants responding to INC.'s survey plan to expand their small business services in 1982.

5. What services should you be using? For 9 out of 10 small companies, outside preparation of tax returns and financial statements is standard. Beyond that, close to half of the small businesses responding to INC.'s survey also rely on their public accountants for tax planning and auditing services.



Not surprisingly, the use of auditors is directly related to company size. Only 1 out of 3 firms with sales of less than $1 million has its statements audited, while close to half (48%) of those in the $3-million-to-$5-million category obtain audits. The number rises to 7 out of 10 companies in the $5-million-to-$25-million sales range, and for those with sales of more than that, independent

HOW ACCOUNTANTS WOULD CHOOSE AN ACCOUNTANT

Criteria ranked most important	Percent of accountants
Personal attention	30%
Reputation	17
Experience	16
Range of services	13
Knowledge of industry	5
Professional competence	5
Quality of service	4
Ability to communicate	3
Accessibility/availability	2
Adequacy of trained personnel	2
Integrity/confidentiality	1
Creativity in planning	1
Timely completion of work	1

Accountants stress personal service, reputation, and experience as the keys to selecting an outside firm. Ironically, timely service – the factor that concerns small businesses most – ranks as the professionals' least important consideration.

COMING TO TERMS WITH ACCOUNTANTS

Like most specialists, accountants have their own set of acronyms and terms. Here is a glossary of the accounting profession's most common ones.

Big Eight: The eight major multinational public accounting firms. Listed alphabetically, with number of U.S. offices in parentheses, the Big Eight includes Arthur Andersen (65); Arthur Young (84); Coopers & Lybrand (85); Deloitte Haskins & Sells (105); Ernst & Whinney (116); Peat, Marwick, Mitchell & Co. (100); Price Waterhouse (69); and Touche Ross (77).

CMA: Certificate in Management Accounting. The CMA is granted by the NAA's Institute of Management Accounting to management accountants who meet certain educational standards, pass a five-part exam, and have at least two years of related professional experience.

CPA: Certified Public Accountant. A CPA is an accountant who has passed certain state requirements, including education, work experience, and an examination prepared by the AICPA and administered by the state.

FASB: Financial Accounting Standards Board. The FASB is an independent body maintained by the Financial Accounting Foundation in Stamford, Conn. Founded in 1972, its purpose is to define, improve, and promote accounting and reporting standards. The board is currently studying the need to develop different standards of financial reporting for small companies.

GAAP: Generally Accepted Accounting Principles. These are the conventions and rules that define accepted practice in preparing general-purpose financial statements.

MAS: Management Advisory Services. This is the term CPAs commonly use to describe their consulting services.

PA: Public Accountant. A PA is an accountant who may meet certain state requirements, is usually registered in the state, but is not certified – i.e., has not passed the Uniform CPA exam.

Major Professional Groups

AAA: American Accounting Association. This is an organization for promoting research and education in accounting. Based in Sarasota, Fla., the AAA has 12,000 members, most of whom are academics.

AICPA: American Institute of Certified Public Accountants. A national society for CPAs, this group prepares and grades the CPA exam for state licensing bodies. With headquarters in New York and 175,000 members, the AICPA is the oldest and largest group in the accounting profession.

NAA: National Association of Accountants. Composed of management accountants, this New York–based group has 100,000 members.

NCCPAP: National Conference of CPA Practitioners. This is a new organization for local and medium-sized accounting firms. Founded in 1979 and based in New York, the group now has about 1,000 members.

NSPA: National Society of Public Accountants. Based in Alexandria, Va., the NSPA is a professional society of 16,000 public accountants.

All five groups above are represented among the 440 respondents to INC.'s survey of accountants. The largest number of respondents belong to AICPA (90%), followed by NCCPAP (27%), NAA (25%), NSPA (4%), and AAA (2%). The total exceeds 100% because some accountants belong to more than one organization. More than 7 out of 10 accountants who responded to the survey also indicated membership in state societies. The participation in state professional groups ranged from 77% of the local accountants to 28% of those representing Big-Eight accounting firms.

audits are a standard procedure.

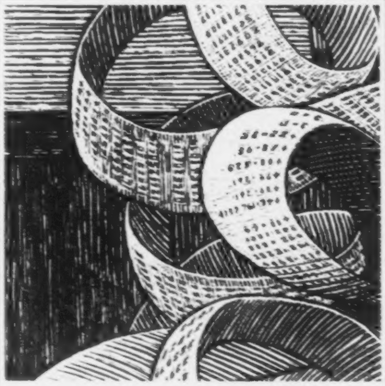
The rest of the services used by small business range from help in designing internal accounting systems to capital investment analysis and evaluation of compensation programs.

In weighing your needs for accounting services, consider the five basic benefits any accounting firm, regardless of size, should provide your company: 1) competent tax assistance; 2) better cost control; 3) order in your accounting system; 4) credibility in your statements; and 5) compliance with the law. Those are the basic payoffs that should govern not only your choice of services but the determination of their value.

6. What should you be paying your accountant? Among companies with sales of less than $1 million, the average annual accounting fee is about $3,000. The tab jumps to $5,300 for companies in the $1-million-to-$3-million sales category, and to $10,600 for those in the $3-million-to-$5-million group. Above that size, the annual fees average anywhere from $16,600 to $42,600.

Accountants responding to the INC. survey indicated that the average annual fee paid by their small business clients is $4,373. The figures range from $2,590 billed by sole practitioners to $13,058 among the Big-Eight accountants.

Overall, the INC. study shows that fees are not a major factor in the relationship between small companies and their accountants. While accounting charges could be lower and fee structures could be clearer, very few of the respondents indicated that fees influence the selection or retention of their public accounting firm. Almost two out of three small companies compensate their accountants on an hourly basis; the rest rely on a flat-fee arrangement.



The new tax law is a good test of your accountant's competence and reliability.

Taking a cue from the banking industry, perhaps, 19% of the public accountants report that they offer preferential rates for small companies. Such rates take the form of reduced fees for start-ups and initial clients, special "introductory" rates, and, in some cases, small-business discounts.

In the final analysis, your accounting costs should reflect the quality of services performed. If the fee seems high, weigh it in terms of the "product" you're getting. If you're getting better financial statements and improved tax work, chances are the higher tab can easily be justified.

7. When should you change accountants? Unlike some larger corporations, small business does not make a practice of rotating accountants. Some 39% of the respondents to INC.'s survey report that their present accounting firm is the *only* accounting firm they have ever had. Among the 61% who have had more than one accountant, 7 out of 10 have changed firms only once or twice. On average, the survey participants have retained their present accountants for more than 8 years. Among the larger companies, where one might expect changes in accountants due to company age and growth, the average period of service is more than 10 years.

The lack of turnover is testimony to the value of retaining an accounting firm that knows your business. It also suggests that the real question is not *when* should you change accounting firms, but *why*.

THE 10 BIGGEST GRIPES ABOUT ACCOUNTANTS

Source of dissatisfaction	Percent of respondents
1. Timely service	35%
2. Reasonable & clear fee structure	22
3. Turnover of professional staff	20
4. Services beyond standard reports	19
5. Knowledge of client business/industry	18
6. Communication & rapport	18
7. Technical knowledge/expertise	18
8. Limited staff	15
9. Orientation toward larger corporations	10
10. Ability to provide clear/concise reports	8

Small businesses cite slow service, confusing fees, and high turnover as the biggest problems in dealing with their outside accountants. Among smaller complaints: ability to keep up with changing regulations and the tendency to be too conservative.

HOW OUTSIDE ACCOUNTANTS ARE USED
Tax help tops the list

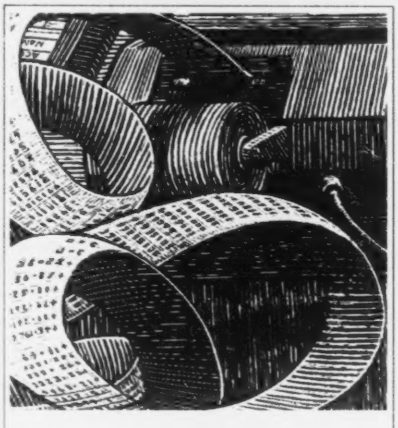
	Annual company sales				
	Under $1 mil.	$1 mil.- 2.9 mil.	$3 mil.- 4.9 mil.	$5 mil.- 24.9 mil.	$25 mil. or more
Accounting services used (ranked by total mentions)	**Percent of respondents**				
Preparation of tax returns	93%	91%	90%	84%	52%
Preparation of financial statements	77	73	72	51	27
Audits of financial statements	32	46	48	71	88
Tax planning	42	51	55	49	39
Review of tax returns	44	46	42	46	49
Preparation of government reports	38	40	37	19	15
Accounting systems design	32	30	25	17	15
Help with employee benefits plans	21	23	27	22	12
Accounting systems implementation	17	20	13	4	3
Forecasting & long-range planning	12	14	17	11	9
Help with loan application	12	15	15	8	6
Evaluation of data processing	5	10	16	15	21
Capital investment analysis	9	10	10	10	3
Design of financial analysis systems	8	9	8	7	3
Evaluation of compensation practices	6	9	7	7	3
Other (bookkeeping; payroll; personal)	3	2	0	3	6

Preparation of tax returns and financial statements tops the list of accounting services used by smaller businesses. While the figures show a direct relationship between company size and audit activity, they also reveal that size has little to do with the limited use of accounting services tied to long-range planning, data processing, and compensation practices.

Many companies rotate accountants as a matter of policy, to generate new ideas and keep the professional on his toes. If all you're getting out of your accountant is tax returns and financial statements, if your accountant thinks only as an auditor and not as an adviser, then a switch probably makes sense. Change for the sake of change, however, is neither productive nor profitable.

Small companies should evaluate their accountants at least once a year to identify anything that may justify a change. The business may simply have outgrown the accountant's capabilities. Is your accountant, for example, keeping pace with your company's needs for more sophisticated advice on matters such as data processing, inflation management, new cost controls, and benefit packages? If your accountant has a thorough knowledge of your business and continues to serve as a sounding board for top management, then there is little merit in making a change.

8. How should you choose an accountant? Suppose a switch is recommended: What guidelines should you use to select a new accounting firm? Small business executives and public accountants agree that the three most important criteria are personal attention, reputation, and experience. Each of these factors, in turn, translates to several critical considerations.



The accounting profession suffers from "Big-Eight Syndrome"—bigger means better.

Personal attention, for example, should be synonymous with commitment, compatibility, and responsiveness. Will the principal of the accounting firm be directly involved in your business? Will you and your staff be comfortable with the individuals who will actually be doing the accounting work? Responsiveness should be measured not only in terms of how long it takes the accountant to return phone calls but what it takes to get him out of his office. If you plan a special year-end tax meeting, for example, how much notice will you have to give the accountant to assure that he'll be there to sit in on the session?

Reputation—the second most important criterion—has little to do with prestige. It's a matter of how bankers, attorneys, and other businesses in your community regard the accounting firm. And don't forget to get a reading on how the accountant stands within his own profession.

Finally, experience counts. What does the accountant know about your industry—specifically, small business in your industry? A current client list will help answer that question, but it is also one that should be addressed personally by those who will be working with your company. Assume that the professional is fluent in accounting and finance; the important question is whether or not he can speak your business's language.

Your accountant should be someone you can trust, someone who understands how your business operates, and someone who is willing to listen and respond with ideas. When you find a public accountant who fits that description, chances are you've found your best professional adviser.

Bradford W. Ketchum, Jr., is a senior editor at INC.

THE FACTS BEHIND THE FIGURES

This article represents the first in a series of special reports on small business and the professions. It summarizes a national study of smaller companies and their public accountants. The primary research for the report was conducted in November and December, 1981. It included two mail surveys supplemented by dozens of telephone interviews with a cross section of small business executives and public accountants.

A four-page questionnaire was mailed to a random sampling of 4,995 INC. subscribers, followed by a two-page questionnaire sent to a random sampling of 2,058 public accountants. Excluding undeliverable and incomplete returns, the net response rates were 20.4% and 21.8%, respectively. Some 993 subscriber returns and 440 accountant returns were then delivered to an independent computer facility for tabulating and 46 cross-reference summaries.

The subscriber respondents represent all 50 states and the District of Columbia, 24% of them with headquarters in the Northeast, 13% in the Southeast, 40% in the Central region, and 23% in the Mountain/Pacific states. Separated into seven industry categories, the majority of respondents are in manufacturing (32%) or wholesale/retail businesses (25%). Other major groups include business services (17%), professional services (13%), and construction/real estate (7%).

The accountant respondents represent 47 states and the District of Columbia; 32% of them have headquarters in the Northeast, 13% in the Southeast, 36% in the Central region, and 19% in the Mountain/Pacific states. While more than 90% of the respondents are Certified Public Accountants, about three out of four represent smaller accounting firms with one office and no more than three partners.

Complete results of the INC. surveys of subscribers and public accountants will be made available. For further information, send a written request to: Bradford W. Ketchum, Jr., INC. Magazine, 38 Commercial Wharf, Boston, MA 02110.

Vital statistics of the two respondent groups in this first study include the following:

Subscribers (993)	
Avg. annual sales ($ mil.)	$5.1
Avg. number of employees	62
Privately held corporation	84%
Publicly held corporation	6%
Proprietorship	7%
Partnership	3%
Use public accounting firm	89%

Accountants (440)	
Sole practitioner	34%
Local	46%
Regional	8%
National	3%
Big Eight	9%
Under 50 employees	83%
Median no. of clients	269

Next month, INC. will publish Small Business and the Professions/II, summarizing a national study of smaller companies and their attorneys.

THE BUCK STOPS HERE *(from page 156)*

But we have had successful past experience with trust funds. It's unlikely, for instance, that we'd ever have built the interstate highway system if a trust fund hadn't been set up to finance it from specific revenue sources. Each administration would have found different and, by its lights, more important things to do with the money.

There's no reason the same principle can't work for small business. If it were thought advisable, the trust fund could be set up outside the control of the executive branch, further away from the political process.

Some companies are selling out to "white knights" in order to avoid being taken over by less desirable merger partners.

To do this, we could replace the SBA by a quasipublic, independent corporation run by a board of businesspeople with special skills and experience in small business. The board would be a bipartisan group, some of whom would be named by the president, some by the Senate majority leader, and some by the Speaker of the House. Directors would serve staggered terms, making it more difficult for a new president to make these appointments political footballs. The employees, like those in the Federal Reserve, would not fall under civil service regulations.

A similar effort to renew or recycle enterprise could be applied to international megamergers. If we set a merger tax in motion, we would certainly have to impose the tax on foreign firms that acquire companies in the United States. But it would be even better to work out a joint tax with other countries, particularly those with whom we do a lot of business. We could amend existing tax treaties in order to impose a tax on international mergers and acquisitions, no matter which country's firm initiated the acquisition.

The two countries involved would divide the tax proceeds according to the percentage of assets of each country's firm that went into the merger. Or, best of all, they could both use the proceeds in a jointly administered fund to support small business import and export programs or joint ventures between smaller firms in the two countries.

We might get even tougher if a foreign government took control of a U.S. firm, as in the case of the recent acquisition of Texasgulf Inc. by Elf Aquitaine Inc., an oil company controlled by the French government. These acquisitions happen more often than most Americans think.

There's no question that one of our stickiest problems internationally would be in dealing with companies owned or directly controlled by foreign governments. But maybe that's the place we most need a tax—or a total ban.

On the domestic front, we could eventually take stronger measures to make those who profit most from megamergers share more of their gains with the rest of us.

Most megamergers, for instance, involve the use of borrowed money. The interest on that debt is now tax deductible. The government could—and probably should—make this interest nondeductible.

We could also make nondeductible the handsome fees paid to investment bankers, lawyers, accountants, and other professionals for their services in facilitating megamergers. We could make it up to these professionals by offering reduced taxes on fees earned from the creation of new, independent businesses by divestiture or spinoff.

We might also impose a stiff surtax on the capital gains made by any stockholder—whether an individual, a company, or a fund—from megamerger profits. The tax would not apply if the stock had been held for, say, at least three years. This surtax would surely cool the megamerger ardor of arbitrageurs and pension fund managers.

As Arthur Burck, a leading merger and acquisition practitioner, pointed out last year in the *New York Times:*

"It is ironic that the taxpayers have been subsidizing the damage and wreckage caused by giant mergers. Invariably these deals depend on tax-free exchanges of stock and/or the tax deductibility of interest on the huge borrowings needed to float the deal. So half the carrying charges are borne by the United States Treasury.

"The solution, of course, is simple: Remove the tax incentives that have so long fueled giant mergers. In that way the activity will shift to the small and medium-sized companies. That is the sector where mergers are needed to keep our capitalism dynamic, to restore the imbalance caused by the burgeoning bigness of past giant mergers."

If all else fails, we could take the step of creating a new bureaucratic tribunal that would be charged with sorting out the "good" mergers from the "bad" ones. Unless and until the president and Congress make our antitrust laws less costly and more effective, few, however, will be keen to adopt that solution.

The one thing we ought not to do is hide any longer from the problem of economic concentration furthered by these giant mergers. If there is a backlash against business because of these mergers—and there will be sooner or later—it will hurt all business, small as well as large.

One thing we ought not to do is hide any longer from the problem of economic concentration furthered by these giant mergers.

To get moving in the direction suggested here will take some attitude changes. Too many of us have yet to recognize the common danger represented by excessive size in government agencies and in government-sized businesses (those with over $5,000 employees). While they differ in many ways, each reduces economic diversity and the size of the independent sector.

National opinion has already swung—and swung hard—against endless government growth. In 1981 we saw the first small drop in employment at all levels of government. This year we must begin to arrest the growth of government-sized business if we are to encourage the largest number of employers in our economy.

James Madison once wrote to Thomas Jefferson that the only basis on which the people could control the powerful was "divide and rule." He made it plain that he was talking about privately based power as well as the power rooted in government. We need to limit the potential power of government-sized business well *before* it affects the practice of free competition that obsesses antitrust practitioners.

If we take moderate, small steps in time, we may not have to take more drastic steps later. ☐

MILTON D. STEWART: THE BUCK STOPS HERE

HOW TO MAKE MEGAMERGERS WORK FOR EVERYONE

The time has come to face up to the problem of "megamergers."

I define a megamerger as any transaction that results in a business with at least $100 million in total assets. This business can be created either from the merger of two giant firms or from one giant firm acquiring a small or medium-sized company.

W.T. Grimm & Co., which keeps book on public mergers and acquisitions, called 1981 "the year of the mega-deal." Grimm measures mergers by the cost to one company of acquiring another. Of the nearly 2,400 mergers it recorded in 1981, 113 cost over $100 million to engineer. Twelve of these deals cost over $1 billion. In contrast, only 4 cost this much in 1980.

The number of these "mega-deals" has climbed steadily since 1975, when there were only 14 in the over-$100-million category. Out of the total 1981 merger cost of $82.6 billion, $38.4 billion came from the 12 over-$1-billion deals.

However dizzying these numbers are, it would not be easy—or necessarily desirable—to wave a legal magic wand and make all megamergers stop or go away. Not all mergers or acquisitions are bad. A few are essential if businesses are to be large enough to survive in some industries. Some represent legitimate efforts to achieve economies of scale in production, research, or marketing.

Year	No. of mergers costing $100 million or more	Year	Total dollar value paid for all mergers ($ billions)
1975	14	1975	11.8
1976	39	1976	20.0
1977	41	1977	21.9
1978	80	1978	34.2
1979	83	1979	43.5
1980	94	1980	44.3
1981	113	1981	82.6

But many of the megamergers don't make a lick of business sense. Experts have estimated that as many as 7 out of 10 of them fail. Some take place simply because profit-chasing sharks, who couldn't care less about the companies involved, want to make a quick buck. The game of megamergers is itself forcing some companies to sell out to "white knights" in order to avoid being taken over by less desirable merger partners.

And whether they're good or bad, there's no question that megamergers reduce the number of producing, employing units in the country. We can't continue to assume that economic diversity will be maintained automatically—that the net increase of new, smaller firms will offset this growing concentration.

As a reasonable first step toward limiting the negative effects of these giant mergers, I propose an "enterprise renewal" or "enterprise recycling" tax. This tax would skim some of the profits from megamergers at the big-dog end of the economy for reinvestment in the business puppies at the small end.

The tax would work this way: Each time a deal took place that involved or resulted in a company with more than $100 million in assets, the government would collect a one-time tax from that firm. The tax would be levied regardless of whether the merger or acquisition involved cash, stock, notes, bonds, or bottle-tops; the rate would increase with the size of the merger.

The proceeds from this tax would go into a "Small Business and Entrepreneurship Trust Fund," which would be used to relieve taxpayers of the costs of present and future federal small business programs. A 1% tax on last year's 12 over-$1-billion deals would have been enough, for example, to cover the administrative costs of the Small Business Administration for a year and a half.

Monies could also be used to cover any losses under guaranteed loan programs or to replace funds now borrowed by the Small Business Administration from the Federal Financing Bank for loans to small business investment companies.

The managers of the budget and Treasury will probably oppose such a special-purpose fund. They hate to lose any revenue from their general fund and like to have the authority, in the name of the president, to determine how revenues are spent.

(continued on page 154)

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Cover photo
Steven Mark Needham

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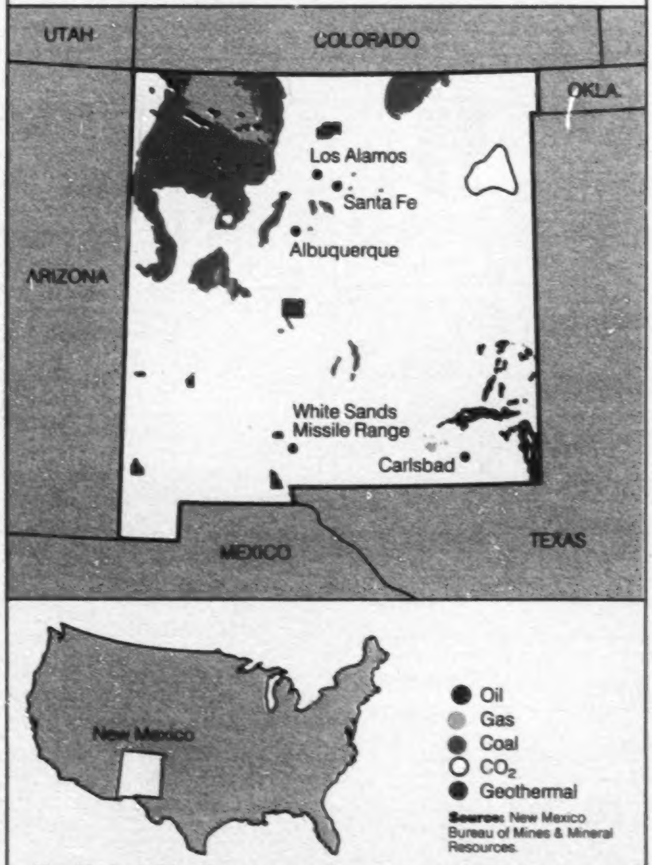
THE GREENING OF NEW MEXICO

Small business diversity could be the key to fast but sensible growth for the "Land of Enchantment" in the '80s.

By Sharon Frederick

New Mexico's Energy Riches



Source: New Mexico Bureau of Mines & Mineral Resources.

New Mexico's 78 million acres produce more energy than it uses.

When he decided to expand his sales effort to the western half of the United States, Allan Thieme looked at plant sites in Arizona, Colorado, Oklahoma, Utah, and even Texas. None had what he wanted.

Then he found Albuquerque, N. Mex. It offered good interstate transportation, plenty of potential employees at wages he could afford, and the promise of better labor relations than he had in heavily unionized Michigan, where he started his now-$8-million company, Amigo, in 1967. A year ago, he followed the lead of companies like Honeywell and Levi-Strauss, and set up shop in Albuquerque.

But 1,500 miles away, Marie Thieme and three of their five children are still working at Amigo's Bridgeport, Mich., plant. There 90 workers turn out the three-wheeled battery-operated "friendly wheelchairs" that Al first designed for Marie when she was diagnosed as having multiple sclerosis. Though Albuquerque is ideal for Thieme's company in many ways, it doesn't provide him with the skilled manufacturing workers or the support operations like machine shops that were so plentiful in Michigan. So he manufactures his wheelchairs in Michigan and assembles those for the western third of the country in Albuquerque.

Albuquerque also hasn't provided him with the money he needs. New Mexico has long had a tight money market, and Albuquerque's reputation as the Southwest's latest boomtown has made some of its banks and investors afraid that too much growth will come too quickly. After 10 months of looking for the $800,000 he needed to build a plant in Albuquerque, Thieme finally gave up. He signed a two-year lease for office and plant space. "If things don't loosen up by the time the lease expires," he says, "I just won't expand as much or as quickly as I'd hoped."

Despite Albuquerque's drawbacks, Thieme remains enthusiastic about the city's potential. He likes its mild four-season climate and friendly people. And he understands why New Mexicans don't want their largest city (population 332,000) to grow too fast. "It's hard working with less money than I'd hoped to find," he says, "but as a businessman with a stake in Albuquerque, I don't want it to become overcrowded and overindustrialized like Denver. I came to Albuquerque to avoid places like Denver and Phoenix."

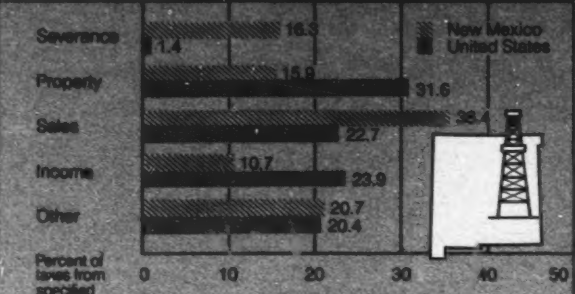
New Mexico doesn't yet have the scars that neighboring states like Arizona and Colorado bear after two decades of rapid growth: overcrowded major cities, pollution, water shortages, and escalating costs. Until very recently, New Mexico has been a place to ski, to hike, or to search for Indian artifacts, but not a place to do business.

But now, New Mexico's low level of economic development is being seen as a plus rather than a minus. It means relatively abundant and inexpensive land, labor, water, and energy. New Mexico's 78 million acres produce more energy than its 1.3 million people use: The state exports about 60% of its oil and over 85% of its natural gas. As a result, the state is no longer poor—at least on the books. The oil-and-gas industry alone pours over $1 million a day into the state coffers in land rental fees, royalties, and severance taxes on the extraction of minerals. Taxes have been cut

Charts by Geoffrey Hodgkinson; Photos by Richard Cross/Gamma Liaison

NEW MEXICO'S ECONOMY AT A GLANCE: ITS POTENTIAL AND PROBLEMS

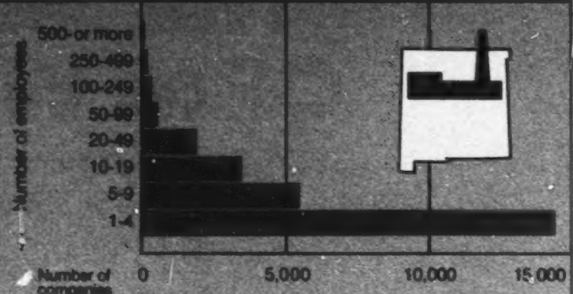
Resources Pay the Bills



Severance taxes, on the extraction of minerals, are a major source of the state's revenue.

Source: New Mexico Taxation & Revenue Dept.

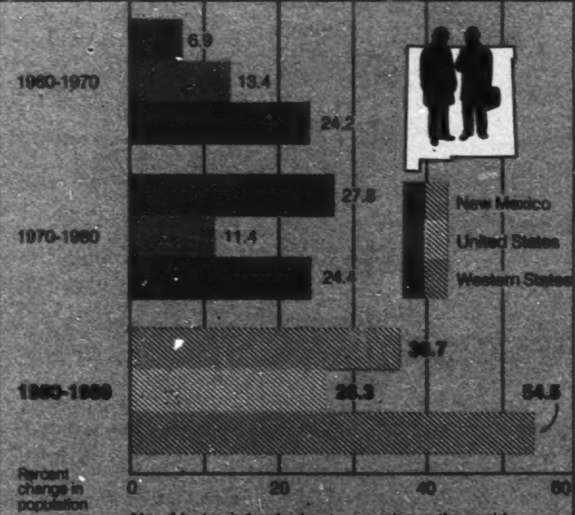
Small Business Provides the Jobs



The very smallest companies have long dominated the state's economy, though that may change fast.

Source: U.S. Dept. of Commerce, Bureau of the Census

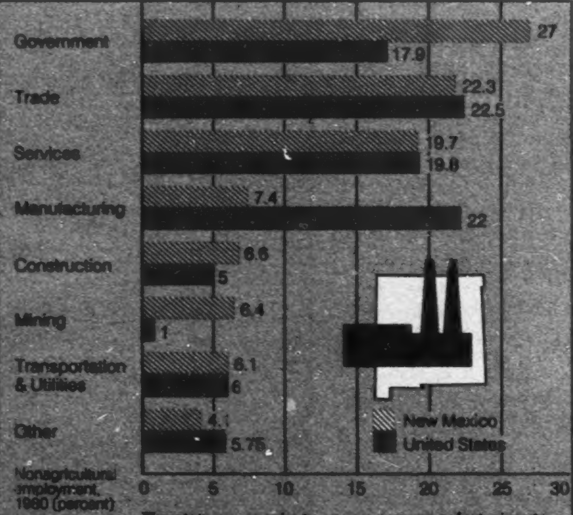
Westward Migration: It Finally Hits New Mexico



New Mexico is beginning to experience the rapid growth its Sunbelt neighbors have already undergone.

Source: U.S. Dept. of Commerce, Bureau of the Census

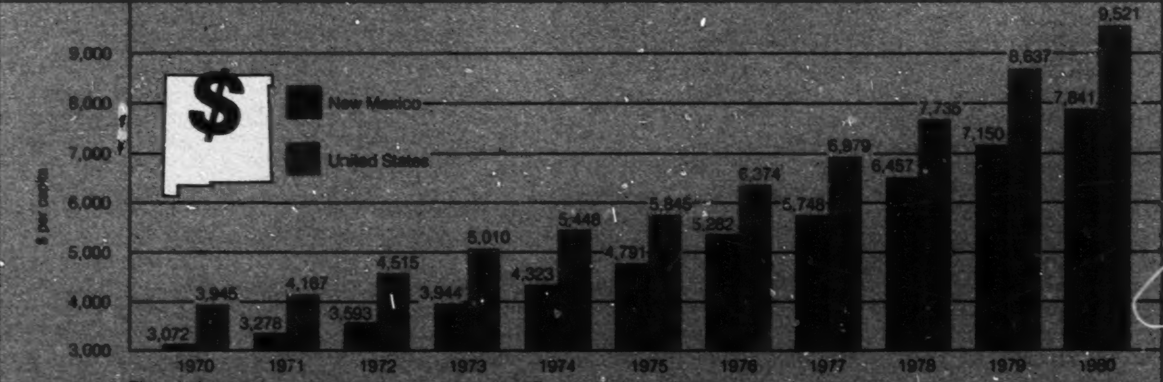
Where People Work



The state now seeks to encourage manufacturing, to create a more diversified economy.

Source: New Mexico Employment Security Dept.

How Personal Income Stacks Up



Though the state hopes to close the gap, its people still earn much less than the national average.

Source: U.S. Dept. of Commerce, Bureau of Economic Statistics every year since 1972, so that a New Mexican's state and local tax bill is now one of the nation's lowest

"To be here now is exciting, challenging, and frustrating," says Lee Zink, University of New Mexico economist and president of the Greater Albuquerque Chamber of Commerce. The major challenge faced by New Mexico is to establish a stable, growing economy that doesn't depend solely on the state's natural resources.

One way to meet that challenge is to create a healthier and more diverse small business sector, Zink says. Since the 1940s, New Mexico's economy has depended on local, state, and federal government employment and spending, particularly on the complex of weapons and energy research labs, testing facilities, and air bases that have created a small pocket of wealth in north central New Mexico—Los Alamos, Albuquerque, and Sante Fe. Over a quarter of New Mexico's 542,000 workers are employed by federal, state, or local government. Another 40% get their paychecks from groceries, restaurants, department stores, specialty shops, car dealers, and motels. In 1980, that left fewer than 200,000 employed in all other sectors—agriculture, construction, manufacturing, finance, and transportation. Another 40,000 were not working at all: Outside of the boomtowns, where jobs go looking for workers, the unemployment rate is over 20%.

Diversification is vital to New Mexico's growth, and Albuquerque has taken the lead. By 1985, companies like Intel and Motorola will have added about 10,000 manufacturing jobs to Albuquerque's current base of 18,000. And Chase Econometrics predicts the growth will continue: It ranks Albuquerque among the 30 U.S. cities that are likely to have the best job growth during the 1980s.

But this attempt to add more industry will succeed only if Albuquerque develops a small business support structure, such as the machine shops Al Thieme needs. Some in Albuquerque think the key to the city's economic development is to encourage start-ups by people whose technological expertise has been developed in the nearby federal research and testing installations. "We're rich in natural resources and we've mined those," says Raymond Radosevich, professor at the University of New Mexico's Anderson School of Management. "But no one's mined our incredible nucleus of technology. We simply don't have the history of entrepreneurship to go with the technology. People who started in weapons research weren't geared to creating a salable product."

The state is also making efforts to see to it that not all the action is in Albuquerque. "Otherwise," says Jim Covell, head of Albuquerque's industrial devel-

WHAT BUSINESS CAN EXPECT IN NEW MEXICO

What does New Mexico offer smaller companies, particularly when compared to its Sunbelt neighbors? Here are some conclusions, based on data gathered by INC. for its "Special Report on State Business Climates" (October 1981) and from interviews with state officials, economic specialists, and small business leaders.

Labor. This is clearly New Mexico's strong suit. It has the highest unemployment rate (7.4% last year) in the Southwest, and some of the lowest wages and rates of unionization in the country. On the other hand, the rate of immigration to the state is low—only about 20% of the projected population increase of 200,000 over the next decade will be people moving from other states—so companies will have to settle for the skills already available.

Albuquerque has over a third of the state's population and offers its most diverse labor pool, but the influx of major electronics firms means stiff competition for employees. The rest of the state has areas that are "real sleepers for smaller firms that don't mind being a bit isolated, can live without super air service, and can utilize local labor and management," says Saul Grohs, vice-president of Fantus Co., New Jersey–based consultants on plant-site location who evaluated the state for several electronics firms.

Capital Resources. New Mexico has historically been capital-poor. The state has only about a half-dozen venture capital firms, all in Albuquerque, and all but one were started within the last seven years. Banks have typically been closely held and have operated quite conservatively. Total assets of all banks and savings and loans in New Mexico were about $8.7 billion last year. (In Arizona, for example, they were $20 billion.) Of the 14,000 commercial banks in the United States, only 89 are in New Mexico.

But the capital environment is improving, largely because of recent interest in the state by outside businesses and investors. Most of the money that flowed into the state in the past was for mining or real estate deals, but now commercial and industrial ventures are attracting attention.

It's undoubtedly more difficult to get venture financing in New Mexico than in more sophisticated financial centers, but it's not as difficult as New Mexicans think it is, says David Livingston, a former New Mexico banker who now heads an investment firm working in New Mexico, Hawaii, and California. And Edmond E. Pace, also a former banker, now with banking consultants Sheshunoff and Co., says, "My guess is that banks in New Mexico go as far as banks anywhere in making small business loans."

Small Business Commitment. New Mexico's political leaders have traditionally taken a hands-off approach to business. They have made no exceptions for small business, though only about 40 companies in the entire state have more than 500 employees. The state has only one major economic incentive to new or expanding companies, an in-plant training program, and only two major state programs aimed specifically at small firms, the year-old Small Business Development Center and the University of New Mexico's Technological Innovation Center. In INC.'s ranking of the states by small business commitment criteria, New Mexico was 30th—a mediocre showing.

Taxes. Taxes in New Mexico have been cut every year since 1972, and last year's cuts were largest for smaller companies, which now pay 4% on net annual earnings up to $1 million. But it still doesn't stack up well against its neighbors, Texas, Arizona, and Colorado, which made the top 10 in the INC. rankings for favorable tax climate. New Mexico ranked only 30th.

Energy Costs. Though New Mexico is rich in energy resources, a company buying electricity there pays more than companies do in many other states. The state's largest utility went to coal-fired power much earlier than most states, and these rates are paying off that investment. New Mexico's Four Corners–area power plants—one of the largest coal-fired, electricity-producing complexes in the United States—produced enough electricity in 1980 to sell 60% of it to other states. But the high cost of electricity and a climate with a large number of cooling days made New Mexico 42nd on INC.'s ranking of state energy costs.

Quality Of Life. Though this one is difficult to measure, it's clear that New Mexico, or at least Albuquerque, stands out here. Albuquerque's four-season climate is mild, the University of New Mexico is located there, and the city is only an hour away from Santa Fe's cultural center and two hours from Taos's skiing.

Jane Dunn (left) runs a "one-stop service center for small business" in Santa Fe. The Small Business Development Center aids clients like Edie Keeler (right).

opment effort, "jobs are in Albuquerque, so people are forced to move here, and we end up with a huge unemployment problem." State economic development people help communities find their strong suits so they can make an effective pitch to out-of-state companies. Roswell, for example, landed a Greyhound bus-building plant by offering the huge hangars of the former Walker Air Force Base, once a major Strategic Air Command operation, and by touting the city's moisture-free climate. Recently, the city won a $22-million federal grant, allowing it to lend low-interest money for expansion of the plant.

In most cases, however, says the state's economic development director, Albert Dietz, "our best bet will be helping our people start and succeed in their own businesses." The Small Business Development Center, started in March 1981, is a "one-stop service center for small business," according to director Jane Dunn. She sets up how-to seminars in communities throughout the state, and follows up with individual consulting sessions for would-be entrepreneurs.

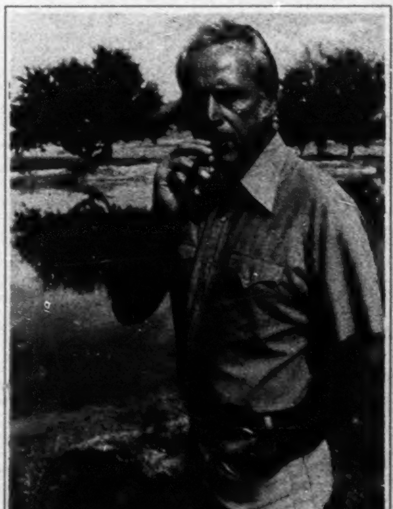
New Mexico's diversity and its ethnic mix complicate any statewide development efforts. "What makes sense for Hobbs, in one of the largest oil-producing counties of the country, doesn't make sense anywhere else," says Dietz. And Lee Zink points out that nearly half the state's population is either Hispanic or Indian, two ethnic groups with strong ties to the land. "The challenge is to find ways for them to remain on the land and still develop economically," says Zink. "The only way to do it is with small businesses."

"One way we can develop a better economy for our tribes," says Floyd Correa, former governor of the Laguna Pueblo tribe, "is to encourage our people to become entrepreneurs." Correa Enterprises, his $500,000 consulting firm, designs computer systems and energy resource development plans. New Mexico's 22 Pueblo, Navajo, and Apache tribes are the largest private owners of proven and potential energy resources in the state. Correa's own reservation is the site of the largest open-pit uranium mine in the world.

The state's Hispanic enterprises are also becoming more diversified. "Ten years ago Hispanics were starting gas stations and retail stores," says Anna Muller, head of the Albuquerque office of the National Economic Development Association (NEDA), a national Hispanic business development organization. "Today they're also starting high-tech businesses, electronics firms, energy firms, and cable-TV stations." One of NEDA's success stories is Nuclear Pharmacy, started by Robert Lee Sanchez in 1974. Sanchez, just out of the University of New Mexico graduate pharmacy program, hit on the idea of "drugstores" that would dispense and deliver radioisotopes to hospitals and then pick up and dispose of the radioactive waste. The company had sales of about $16 million in fiscal 1981 and ranked 48th on the 1981 INC. 100 (See INC., May 1981).

While there's plenty of ideological support for small business in New Mexico, many say that the support that really counts—money—is in short supply. "The legislature is dominated by people who came to power when New Mexico was a poor little state that had to underfund everything," says Jerry Jordan, an economist and former dean of the UNM Anderson School of Management, and now a member of President Reagan's Council of Economic Advisors. "The dominant attitude is, when in doubt, cut taxes."

The legislature has cut taxes every year since 1972, and in the 1981 session it emphasized cuts for firms whose an-



Tight-fisted bankers caused Edward J. Myslik to start a venture capital firm.

nual earnings are less than $3 million. But the legislature did not fund measures that Zink and others see as crucial to the growth of the state's smaller businesses, such as the university's fledgling innovation center. Nor does the state fund a standing committee on either small business or economic development. The only state-funded lure to business is a nine-year-old $1-million inplant training program that provides grants to new or expanding manufacturers.

On the other hand, the state's financial stability is a plus, says Al Dietz: "We have no gimmicks, but we've got a $2-billion state fund that means we can offer a business environment with no surprises like deficits that require new taxes." The state's general permanent fund, fed by land-use fees and royalties, and a newer severance-tax permanent fund now total over $1.5 billion. That money ought to be used more aggressively for economic development, argues Jim Covell: "Unfortunately, the tendency is to build a new building with a legislator's name on it rather than fund a research and development program to spawn new companies."

The large new companies moving into New Mexico are improving the environment for smaller businesses in some unexpected ways. New Mexico has always been capital-poor, and bankers have been able to pick and choose their deals. That frequently meant avoiding high risks, such as start-ups. "Now representatives of big electronics firms are coming to our bankers with forms that ask questions like how many service stations and machine repair shops you have in your community," says Albuquerque businessman Edward J. Myslik, Jr. "Bankers are taking small businesses a lot more seriously as a result." That's quite a change from even four years ago, he says, when Myslik and several business associates launched a small private venture-capital firm. It was only the second in Albuquerque, and the first limited itself to construction projects. "Banks used to send prospective clients to me," Myslik recalls.

New Mexico has everything Allan Thieme needs except money and skilled labor.

Small investors are also coming on the scene in New Mexico. Jim Covell gets a call or two a month from out-of-staters interested in partial ownership of a business or in developing projects such as small commercial buildings. "It's one of the most encouraging steps I've seen," says Covell. "In the past, we were a capital-drain state: More investment went out than came in. As we develop our high-technology manufacturing base, we'll see more people coming in with both ideas and financial resources—those who until now went to Texas or California once they got tired of IBMsville."

As Lee Zink says, "For a long time we in New Mexico have had the poor man's attitude toward the future: There is no future for me; all I can do is be nice to the guy who provides my livelihood. That's no longer the case. We have astounding opportunities. We simply must realize them." □

Sharon Frederick is a Boston–based freelance writer and a former editor at INC.

Robert Lee Sanchez's Nuclear Pharmacy is an INC. 100 company and one of the success stories in New Mexico's Hispanic community. The firm handles radioisotopes for hospitals; it had sales of about $16 million in fiscal 1981.

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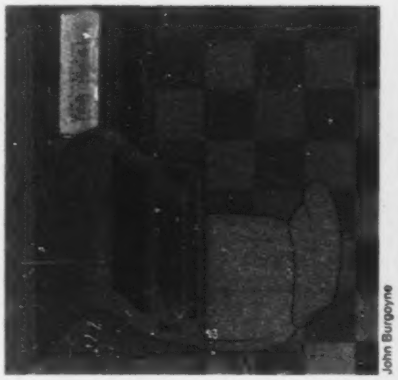
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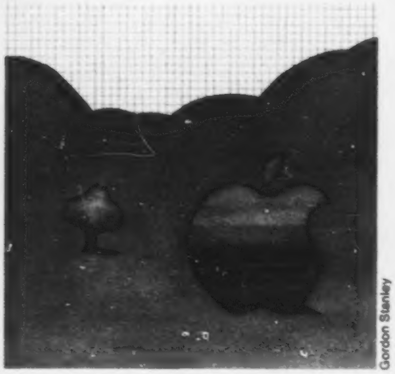
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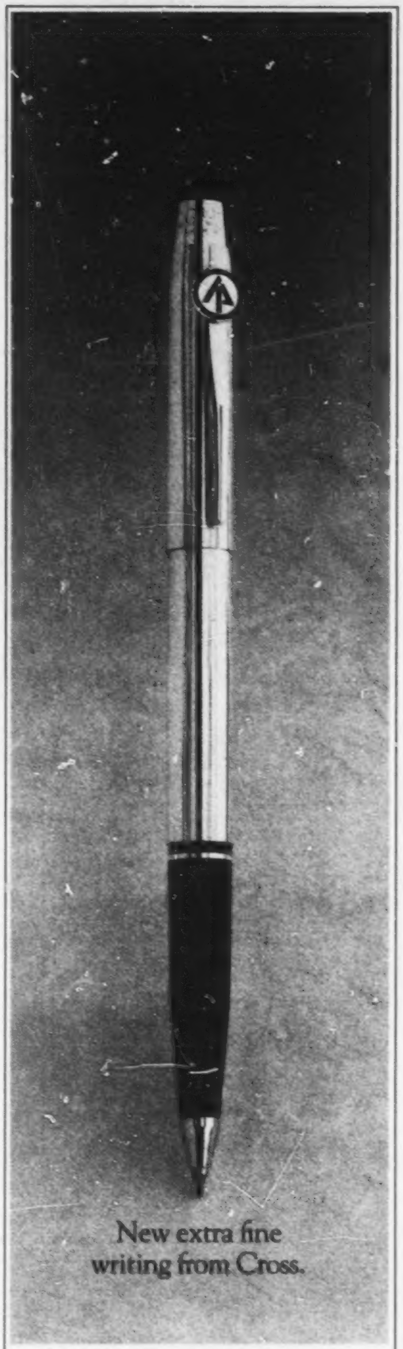

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Cover Story

THE 1982 INC. 100

Despite an ailing economy, America's fastest-growing public companies are keeping a breathless pace.

By Bradford W. Ketchum Jr.

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Battered by a billion-dollar deficit in the auto industry, a pronounced slump in housing activity, and sluggish retail sales, American business found little to celebrate when the books closed on 1981. The nation's 1,000 largest corporations staggered into 1982 with sales running only 4% ahead of inflation and aftertax profits barely matching it.

There is a bright side to the economy of the past year, however, and it can be found in the 1982 INC. 100—the fourth annual ranking of the fastest-growing publicly held smaller corporations in the United States. While the giants posted a 1981 sales gain of about 12%, the INC. 100 companies chalked up a vigorous 77% increase. Similarly, while the nation's 1,000 largest companies mustered a 7% to 8% gain in aftertax earnings, the INC. 100 closed 1981 with a 107% surge in profits.

> While the nation's 1,000 largest companies mustered a 7% to 8% gain…the INC. 100 closed 1981 with a 107% surge in profits.

Spectacular as the INC. 100's 1981 performance was, it represents only the most recent installment in a five-year period best described as explosive. From 1977 to 1981, sales of the 100 companies soared by 1,247%, or at an average compound annual rate of 92%. All but two companies that qualified for this year's ranking registered at least a sevenfold increase in sales during the 1977–81 base period.

Led by California's Apple Computer and anchored by New Jersey's Matrix, maker of diagnostic imaging systems, the 100 companies are ranked according to their percentage increase in sales or revenues, based on 1977 and 1981 fiscal year results. Five years ago, the 100 firms averaged $3.7 million in sales, with the majority generating less than $2 million. Only 11 topped $10 million, and none had more than $22.3 million in revenues. Today, the INC. 100's average volume is $49.5 million, with 54 companies surpassing the $25-million mark.

Sporting nameplates ranging from the exotic, such as HemoTec and Healthdyne, to the simple, such as Liz Claiborne and Taco Charley, the ranking represents a diverse range of manufacturing, mining, and service industries. It includes 24 computer and business equipment makers, 11 oil and gas producers, 9 manufacturers in the medical field, 3 restaurant chains, and 2 airlines. The elite group is headquartered in 28 states: California is the front-runner with 17 companies, followed by New York and Texas with 15 each, and Minnesota with 7.

Diverse as they are in industry and location, the INC. 100 share four qualities: youth, innovation, high productivity, and a healthy bottom line. Fifty-six have incorporated since 1972; 89 have incorporated since 1962. On average, the INC. 100 firms have been in business less than 12 years.

Start-ups not long ago, they are now the upstarts on the frontier of high technology and creative services. The list includes pioneers in computer leasing, seismic data processing, technological training, and oil-field services, as well as nuclear medicine, laser scanners, ferrofluidic technology, and video games.

Products of the free enterprise system, the INC. 100 have accelerated competition and outpaced giant counterparts in the country's fastest-growing fields (see "Born to Grow," page 59). Among the 15 INC. 100 companies in the computer industry, for example, the five-year compound average growth rates range from 67% (Compucorp) to 356% (Apple). The INC. 100 contingent in the medical equipment field has pulsed with compound rates of 62% (Matrix) to 226% (Electro-Biology), while the 11 energy producers are not far behind with a range of 74% (Seneca Oil) to 148% (Gulf Energy). Overall, while total sales posted by the nation's 500 largest corporations rose 70% between 1977 and 1981, the INC. 100's sales skyrocketed to a gain of 1,247%.

Using sales per employee as a yardstick, the smaller growth companies generate greater volume per worker than most of their giant counterparts. Last year, for example, Tomlinson Oil and Sterling Pipe & Supply rang up more sales per employee—$2.0 million and $1.5 million, respectively—than any firm on the *Fortune* 500. Other industry standouts include Apple Computer and Cado Systems, which each generated more than $137,000 per worker, compared with IBM's $83,000. On average, the INC. 100 generated $79,152 per employee last year.

More important than employee sales statistics, however, is the growth in the number of employees among the INC. 100. In the past five years, the overall size of the group's work force has soared by 607%—a significant figure compared with the meager 2% increase registered by the top 500 industrials. As a group, the 100 companies have created an estimated 54,000 net new jobs since 1977. Among the 55 companies whose growth has been generated internally and not by acquisition, the increase in number of employees is 620%. In short, their payrolls have expanded more than sevenfold, an achievement that translates into 18,500 new jobs in the past five years.

While the majority of the INC. 100 companies expanded internally during the 1977–81 period, acquisitions have played a role in the growth of 45 firms. Leading the list of acquirers is Chemical Investors, an Indianapolis-based chemical conglomerate that has undergone a dramatic shift from distribution to manufacturing in the past five years. Jumping from a zero base in 1976 to sales of $5.2 million in 1979, Chemical Investors then concocted a leveraged buyout that resulted in the 1980 acquisition of Borden's $32-million Mystik Tape Division. Following two more acquisitions in 1981, the company celebrated the beginning of 1982 with the purchase of $25-million Arno Adhesive Tape.

> From 1977 to 1981, sales of the 100 companies soared by 1,247%, or at an average compound annual rate of 92%.

As their P&L statements testify, the INC. 100 firms are as profitable as they are innovative and productive. From 1977 through 1981, total net income for the 100 companies soared by 3,846%. Though 26 companies closed 1977 in the red, only 8 were wrestling with deficits at the end of 1981. More important, 86 posted gains in earnings last year, with net profits at 8.9% of sales, up from 2.8% five years ago. Not surprisingly, among the hardest hit in the loss column last year were Air Florida and Tomlinson Oil, both of whom saw black ink evaporate into losses exceeding $5 million.

Pegging the INC. 100's return on equity is difficult, if not impossible. Small growth companies in general are highly leveraged, and the companies that make up the INC. 100 are no exception. Sub-

INC. 100 sculpture by Nicholas Fasciano; photo on page 49 by Ralph King.

stantial changes in equity due to new stock issues, coupled with the idiosyncracies of calculating return ratios, frequently distort the figures. By INC. estimates, however, the 1981 return on equity among the 100 firms averaged a highly enviable 34.7%.

As with any ranking of elite companies, the INC. 100 raises curiosity about the firms that finished as runners-up and those that were disqualified. At press time, Infotron Systems, a Cherry Hill, N.J., maker of multiplexers and modems with 1981 sales of $22 million and a five-year gain of 583%, emerged as No. 101. Among other runners-up are more than 100 companies that have at least quadrupled or quintupled their sales in the past five years. They include 21 members of last year's INC. 100 (see "Where's the Class of '81?", page 65) and such fast-track performers as Empire Oil & Gas (up 582%), TIE/Communications (581%), and Sykes Datatronics (569%).

Among the companies disqualified, the most noteworthy this year are those that were eliminated because they have yet to establish a five-year sales history or because their 1977 sales were less than $100,000. These newcomers testify to the meteoric growth of emerging companies. Among celebrated companies with limited histories are Pizza Time Theatre, Magnuson Computer, and Kloss Video, none of which were generating sales five years ago. Since 1978, however, Pizza Time Theatre's sales have soared by 10,308% and Magnuson's by 8,473%. Kloss Video, which began developing revenues in 1979, has registered a 1,736% gain in three short years.

> As their P&L statements testify, the INC. 100 firms are as profitable as they are innovative.

The challengers also include at least five notable examples of companies that began their takeoffs in 1977 but had not reached the $100,000 level by year-end. With sales that have since rocketed by amounts ranging from 36,000% to more than 296,000%, the explosive quintet includes Biochem International (up 296,270%, with '81 sales of $4.3 million); Movie Systems (188,002% with sales of $7.8 million); Genentech (81,750%, $21.3-million sales); Petro-Silver (65,027%, $9.8-million sales); and St. Jude Medical (36,061%, $13.2-million sales). Barring an unexpected stall in 1982, all will be among the top newcomers in next year's INC. 100. ☐

Bradford W. Ketchum, Jr., is a senior editor at INC.

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Trading	Company (Rank)
OTC	Air Florida System** (14)
OTC	Alaska Diversified Resources (85)
OTC	AM Cable TV Industries (49)
OTC	Amarco Resources* (61)
OTC	Andersen 2000* (59)
OTC	Apple Computer (1)
OTC	Aracca Petroleum (72)
OTC	ASK Computer Systems (8)
OTC	Barton Valve (51)
OTC	Bradford Computer (11)
OTC	Bio-Medical Sciences* (4)
AMEX	Blocker Energy (71)
OTC	Cado Systems** (55)
OTC	Centuri (33)
OTC	Chemical Investors (9)
OTC	Chemold* (25)
AMEX	Commodore** (79)
OTC	Compucorp (95)
OTC	Computer Associates Int'l. (40)
OTC	Computer Designed Systems (42)
OTC	CPT‡ (93)
NYSE	Cray Research*** (80)
OTC	Creative Foods* (34)
OTC	C3* (89)
OTC	David Jamison Carlyle (77)
OTC	Dysan* (43)
OTC	Electro-Biology* (2)
AMEX	EnerServ Products (92)
OTC	Ferrofluidics (94)
OTC	Flare (3)
OTC	Flight Transportation* (31)
OTC	Geophysical Systems (58)
OTC	Gulf Energy* (15)
OTC	HBO & Co. (91)
OTC	Health Extension Services* (65)
OTC	Healthdyne (35)
OTC	HemoTec (30)
NYSE	Heritage Communications† (38)
OTC	Hurco Manufacturing* (90)
OTC	Immuno Nuclear (78)
OTC	Intelligent Systems* (82)
OTC	Inter-Tel* (19)
OTC	Interface Mechanisms** (73)
OTC	Intergraph (66)
OTC	Int'l. Game Technology (24)
AMEX	Intertec Data Systems (37)
OTC	Jefferson-Williams Energy (6[illegible])
OTC	Key Pharmaceuticals* (74)
OTC	Kyle Technology (88)
OTC	Lexidata (17)
OTC	Liz Claiborne (36)
OTC	Machine Technology (68)
OTC	Magnetic Head* (28)
OTC	Majestic Electro Industries (64)
OTC	Matrix** (100)
OTC	M.D.C.* (32)
OTC	Micom Systems (12)
OTC	Microdyne (97)
OTC	Miller Tech. & Communications (52)
OTC	Minnetonka* (87)
NYSE	NBI** (20)
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OTC	RSI** (10)
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OTC	Sea Galley Stores (44)
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OTC	Taco Charley (29)
OTC	Tandem Computers*** (18)
OTC	Tandon* (13)
OTC	Team* (96)
OTC	Texas Energies* (60)
OTC	Tomlinson Oil*** (47)
OTC	Triad Systems** (57)
OTC	Vector Graphic (6)

*1981 INC. 100 **1980–81 INC. 100 ***1979–80–81 INC. 100 †1980 INC. 100 ‡1979–80 INC. 100 OTC – over-the-counter AMEX – American Stock Exchange NYSE – New York Stock Exchange

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Rank '82	Rank '81	Company	Sales Growth '77-'81 Percent increase (comp. annual rate)	'81 Sales ('77 Sales) ($000)	'81 Net income ($000)	'77 Net income ($000)	'81 Net income as % of sales	No. of employees '81	No. of employees '77	Acquisitions '77-'81	Date inc.	Business description
1	☐	**Apple Computer** (Cupertino, CA)	43,154% *356%*	$334,783 *$ 774*	$39,420	$ 42	11.8%	2,400	10	Yes	1977	Mfr. microcomputers
2	6	**Electro-Biology** (Fairfield, NJ)	11,184 *226*	13,315 *118*	1,107	(177)	8.3	163	10	No	1975	Mfr. medical equip.
3	☐	**Flare** (Midland, TX)	7,797 *198*	9,160 *116*	1,190	11	13.0	100	8	No	1975*	Seismic data services
4	18	**Bio-Medical Sciences** (New York, NY)	7,159 *192*	80,499[1] *1,109*	5,870[1]	(2,857)	7.3[1]	850	50	Yes	1967	Mfr. women's sportswear
5	☐	**Seisdata Services** (Houston, TX)	6,560 *186*	11,456[1] *172*	1,130[1]	13	9.9[1]	240	18	No	1977	Seismic data services
6	☐	**Vector Graphic** (Thousand Oaks, CA)	6,097 *181*	25,035 *404*	2,645	(38)	10.6	279	46	No	1976	Mfr. microcomputers
7	11	**Seal Fleet** (Galveston, TX)	4,286 *157*	12,287[1] *280*	2,289[1]	(127)	18.6[1]	277	4	No	1969	Offshore supply services
8	☐	**ASK Computer Systems** (Los Altos, CA)	4,219 *156*	13,000 *301*	1,491	28	11.5	98	17	No	1974	Software systems
9	☐	**Chemical Investors** (Indianapolis, IN)	4,183 *156*	38,080 *889*	(421)[2]	(308)	loss	370	22	Yes	1976	Mfr. chemicals, ind'l. tapes
10	20	**RSI** (Greenville, SC)	3,996 *153*	63,819 *1,558*	3,539	(162)	5.5	750	198	Yes	1972	Mfr. heat equip.; bottler
11	☐	**Bedford Computer** (Bedford, NH)	3,986 *153*	5,148 *126*	454	0	8.8	65	12	No	1977	Mfr. graphic composition systems
12	☐	**Micom Systems** (Chatsworth, CA)	3,962 *152*	32,818 *808*	3,948	4	12.0	503	20	Yes	1973*	Mfr. data commun. equip.
13	5	**Tandon** (Chatsworth, CA)	3,876 *151*	54,152 *1,362*	4,505	89	8.3	1,140	300	No	1976	Mfr. flexible disk drives
14	27	**Air Florida System** (Miami, FL)	3,793 *150*	304,160 *7,814*	(5,881)	(2,145)	loss	2,370	308	Yes	1955	Commercial airline
15	3	**Gulf Energy** (Salt Lake City, UT)	3,672 *148*	9,166 *243*	575	(106)	6.3	75	17	Yes	1968	Oil, gas & coal development
16	☐	**Sage Energy** (San Antonio, TX)	3,161 *139*	56,832 *1,743*	12,733	164	22.4	350	98	No	1977	Oil & gas explor., drilling
17	☐	**Lexidata** (Billerica, MA)	2,760 *131*	14,529 *508*	2,053	16	14.1	239	10	No	1974	Mfr. display processors
18	4	**Tandem Computers** (Cupertino, CA)	2,610 *128*	208,397 *7,691*	26,549	325	12.7	2,730	137	No	1974	Mfr. computers
19	64	**Inter-Tel** (Phoenix, AZ)	2,518 *126*	43,353 *1,656*	3,876	103	8.9	350	30	Yes	1969	Mfr. telephone systems
20	9	**NBI** (Boulder, CO)	2,432 *124*	57,628 *2,276*	7,158	(770)	12.4	1,079	82	No	1973	Mfr. word-processing systems
21	21	**Sterling Oil of Oklahoma** (Tulsa, OK)	2,379 *123*	18,001[1] *726*	143[1]	114	0.8[1]	270	20	Yes	1948	Oil & gas production; mfr. mobile quarters
22	24	**Sterling Pipe & Supply** (Oklahoma City, OK)	2,228 *120*	106,164 *4,561*	3,281	91	3.1	73	13	No	1976	Oil field equip. supplier
23	☐	**Nupec Resources** (Riverton, WY)	2,207 *119*	2,376 *103*	444	17	18.7	50	5	No	1976	Mineral explor. & devel.
24	☐	**Int'l Game Technology** (Reno, NV)	2,080 *116*	61,510 *2,821*	13,892	300	22.6	525	38	No	1952*	Mfr. coin-op. video games
25	42	**Chemold** (Binghamton, NY)	2,068 *116*	36,751 *1,695*	1,225	2,018	3.3	416	250	Yes	1949	Mfr. women's sportswear
26	12	**Nutri/System** (Huntingdon Valley, PA)	1,948 *113*	49,183 *2,402*	9,246	473	18.8	674	93	Yes	1976	Owner/franchisor weight-loss centers
27	8	**Network Systems** (Brooklyn Park, MN)	1,913 *112*	21.014 *1,044*	3,542	(1,751)	16.9	236	85	No	1974	Mfr. data commun. equip.
28	28	**Magnetic Head** (Glen Head, NY)	1,892 *111*	9,023 *453*	(318)	24	loss	140	27	Yes	1968	Mfr. precision parts & coatings
29	☐	**Taco Charley** (San Mateo, CA)	1,889 *111*	11,158 *561*	(1,017)	(171)	loss	652	65	No	1975	Mexican fast-food restaurants
30	☐	**HemoTec** (Englewood, CO)	1,800 *109*	1,938 *102*	304	(128)	15.7	35	7	No	1974	Mfr. surgical monitoring syst.

1–Estimate (12/31 closing, fig. unavailable at press time) 2–Nine-month fig. *Predecessor

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Rank		Company	Sales Growth '77-'81 Percent increase (comp. annual rate)	'81 Sales ('77 Sales) ($000)	'81 Net Income ($000)	'77 Net Income ($000)	'81 Net income as % of sales	No. of employees		Acquisitions '77-'81	Date Inc.	Business description
'82	'81							'81	'77			
31	94	**Flight Transportation** (Eden Prairie, MN)	1,706% *106%*	$24,844 *$1,376*	$2,291	$ (94)	9.2%	140	55	Yes	1968	Charter airline; aviation services
32	63	**M.D.C.** (Denver, CO)	1,590 *103*	60,923 *3,605*	5,187	297	8.5	153	25	No	1972	Residential construction, developer
33	☐	**Centuri** (Hialeah, FL)	1,581 *102*	61,460 *3,657*	7,519	(3,095)	12.2	250	15	No	1968*	Mfr. coin-op. video games
34	15	**Creative Foods** (Port Washington, NY)	1,576 *102*	18,489 *1,103*	123	(343)	0.7	103	21	No	1969	Burger King restaurants
35	☐	**Healthdyne** (Marietta, GA)	1,514 *100*	7,407 *459*	774	81	10.4	370	35	Yes	1970	Mfr. electronic medical equip.
36	☐	**Liz Claiborne** (New York, NY)	1,480 *99*	116,831 *7,396*	10,182	342	8.7	351	29	No	1976	Mfr. women's sportswear
37	☐	**Intertec Data Systems** (Columbia, SC)	1,464 *99*	17,156 *1,097*	3,731	18	21.7	165	14	No	1973	Mfr. microcomputers
38	108	**Heritage Communications** (Des Moines, IA)	1,440 *98*	77,157 *5,010*	3,812	(3,899)	4.9	1,897	135	Yes	1971	Operates cable TV systems; display commun.
39	☐	**Nuclear Support Services** (Woodbridge, VA)	1,433 *98*	16,957 *1,106*	680	85	4.0	400	100	No	1973	Nuclear utility services
40	☐	**Computer Associates Int'l** (Jericho, NY)	1,386 *96*	18,456 *1,242*	1,234	5	6.7	327	20	Yes	1974	Software systems
41	37	**Pacer Technology & Resources** (Campbell, CA)	1,353 *95*	5,275 *363*	(454)	2	loss	98	18	No	1976	Mfr. acrylics & ind'l adhesives
42	☐	**Computer Designed Systems** (Minneapolis, MN)	1,336 *95*	1,910 *133*	204	(12)	10.7	30	10	No	1977	Software & EDP services
43	38	**Dysan** (Santa Clara, CA)	1,278 *93*	104,202 *7,563*	5,158	1,068	5.0	2,300	346	Yes	1972	Mfr. magnetic memory media
44	☐	**Sea Galley Stores** (Mountlake Terrace, WA)	1,275 *93*	49,000 *3,564*	2,205	180	4.5	2,400	360	Yes	1968	Restaurants, food processing
45	☐	**Royalpar Industries** (West Hartford, CT)	1,193 *90*	12,634 *977*	70	(129)	0.6	252	40	No	1965	Technical personnel & services
46	54	**Shopsmith** (Vandalia, OH)	1,167 *89*	62,496 *4,931*	2,258	218	3.6	1,190	154	Yes	1972	Mfr. woodworking equip.
47	30	**Tomlinson Oil** (Wichita, KS)	1,151 *88*	132,796 *10,616*	(5,387)	245	loss	65	32	Yes	1957	Oil & gas explor., refining
48	13	**Printronix** (Irvine, CA)	1,120 *87*	52,428 *4,298*	4,639	270	8.8	880	115	No	1974	Mfr. computer line printers
49	117	**AM Cable TV Industries** (Coopersburg, PA)	1,081 *85*	14,640 *1,240*	1,299	12	8.9	457	44	Yes	1974	Constructs aerial networks
50	110	**Oxoco** (Houston, TX)	1,075 *85*	28,341 *2,413*	5,563	97	19.6	175	14	Yes	1972	Oil & gas explor.; mfr. compressors
51	☐	**Barton Valve** (Shawnee, OK)	1,035 *84*	22,584 *1,989*	4,377	31	19.4	232	29	Yes	1967	Mfr. valves & parts for petroleum ind.
52	☐	**Miller Tech. & Communications** (Phoenix, AZ)	990 *82*	5,626 *516*	677	20	12.0	120	30	No	1972	Tech. training; software; video products
53	177	**Pengo Industries** (Fort Worth, TX)	989 *82*	182,163 *16,727*	15,810	1,323	8.7	3,700	86	Yes	1977	Mfr. oilfield equip., chemicals; well services
54	76	**Swanton** (New York, NY)	984 *81*	14,504 *1,338*	1,790	(515)	12.3	50	10	No	1972	Financial services; coal operations
55	10	**Cado Systems** (Torrance, CA)	984 *81*	46,085 *4,252*	5,539	325	12.0	335	74	No	1973	Mfr. microcomputers
56	175	**Omnimedical** (Anaheim, CA)	983 *81*	37,651 *3,477*	1,667	(413)	4.4	555	128	Yes	1971	Medical diagnostic services
57	40	**Triad Systems** (Sunnyvale, CA)	978 *81*	78,391 *7,269*	8,863	781	11.0	1,092	135	No	1972	Mfr. turnkey microcomputer systems
58	☐	**Geophysical Systems** (Pasadena, CA)	977 *81*	35,895 *3,332*	4,320	151	12.0	850	50	No	1972	Mfr. seismic data systems & processing
59	90	**Andersen 2000** (Atlanta, GA)	972 *81*	9,776 *912*	960	18	9.8	30	14	No	1971	Mfr. pollution control equip.
60	44	**Texas Energies** (Amarillo, TX)	961 *80*	2,259 *213*	342	8	15.1	100	6	No	1966	Oil & gas explor.
61	34	**Amarco Resources** (Dallas, TX)	931 *79*	11,923 *1,157*	817	83	6.9	195	53	Yes	1972	Oil & gas well services
62	17	**Saxon Oil** (Dallas, TX)	922 *79*	81,467[1] *7,974*	1,176[1]	612	1.4[1]	134	20	No	1968	Oil & gas explor. and production
63	23	**Symbol Technologies** (Hauppauge, NY)	916 *79*	3,220 *317*	(340)	(283)	loss	70	7	No	1973	Mfr. laser scanners for bar coding
64	☐	**Majestic Electro Industries** (New York, NY)	899 *78*	30,204 *3,024*	484	167	1.6	42	110	Yes	1977	Mfr. lighting fixtures
65	74	**Health Extension Services** (Syosset, NY)	897 *78*	12,339 *1,238*	361	5	2.9	2,000	300	Yes	1975	Home health care services

1-Estimate (12/31 closing, fig. unavailable at press time) 2-Nine-month fig. *Predecessor

Rank '82	Rank '81	Company	Sales Growth '77-'81 Percent increase (comp. annual rate)	'81 Sales ('77 Sales) ($000)	'81 Net Income ($000)	'77 Net Income ($000)	'81 Net Income as % of sales	No. of employees '81	No. of employees '77	Acquisitions '77-'81	Date Inc.	Business description
66	☐	**Intergraph** (Huntsville, AL)	893% *78%*	$91,097 *$9,173*	$8,268	$ 441	9.1%	1,275	190	No	1969	Mfr. drafting systems
67	☐	**Jefferson-Williams Energy** (Dallas, TX)	878 *77*	8,281 *847*	388	(46)	4.7	71	7	No	1974	Oil & gas explor. and production
68	☐	**Machine Technology** (Whippany, NJ)	867 *76*	7,270 *754*	432	89	5.9	95	30	No	1971	Mfr. systems for semiconductor mfg.
69	48	**Nuclear Pharmacy** (Albuquerque, NM)	863 *76*	16,023 *1,663*	556	209	3.5	326	146	Yes	1974	Dispenser of radio-pharmaceuticals
70	56	**Petroleum Equipment Tools** (Houston, TX)	855 *76*	155,598 *16,296*	31,104	2,349	20.0	1,200	438	Yes	1967	Rents oil & gas drilling equip.
71	☐	**Blocker Energy** (Houston, TX)	842 *75*	136,040 *14,435*	4,346	778	3.2	1,350	207	No	1975*	Shallow-water drilling
72	☐	**Aracca Petroleum** (New York, NY)	838 *75*	1,520[1] *162*	203[1]	(80)	13.4[1]	15	3	No	1969	Oil & gas explor. and production
73	75	**Interface Mechanisms** (Lynnwood, WA)	837 *75*	15,636 *1,668*	1,679	238	10.7	240	44	No	1969	Mfr. bar code printers & readers
74	84	**Key Pharmaceuticals** (Miami, FL)	821 *74*	41,431 *4,500*	5,976	555	14.4	600	102	Yes	1947	Mfr. ethical drugs
75	35	**Reeves Communications** (New York, NY)	811 *74*	129,586 *14,221*	10,641	634	8.2	2,000	50	Yes	1969	Producer/distributor films & TV programs
76	85	**Seneca Oil** (Oklahoma City, OK)	811 *74*	11,651 *1,279*	1,412	279	12.1	134	10	No	1936	Oil & gas explor.; contract drilling
77	☐	**David Jamison Carlyle** (Los Angeles, CA)	807 *74*	30,132 *3,321*	1,032	10	3.4	80	2	Yes	1975	Computer & telecommunications equip. services
78	☐	**Immuno Nuclear** (Stillwater, MN)	798 *73*	3,214 *358*	679	(97)	21.1	59	17	No	1975	Mfr. diagnostic & clinical products
79	57	**Commodore** (Syracuse, IN)	793 *73*	199,302 *22,320*	4,802	3,186	2.4	2,200	494	Yes	1952	Mfr. mobile homes & recreational vehicles
80	7	**Cray Research** (Mendota Heights, MN)	792 *73*	101,642 *11,393*	18,170	2,027	17.9	1,079	199	No	1972	Mfr. large-scale computers
81	88	**Paradyne** (Largo, FL)	782 *72*	135,413 *15,358*	17,508	1,554	12.9	2,462	328	Yes	1969	Mfr. data communications systems
82	14	**Intelligent Systems** (Norcross, GA)	779 *72*	18,775 *2,135*	1,591	100	8.5	239	64	No	1973	Mfr. display terminals & desktop computers
83	65	**Quality Care** (Rockville Centre, NY)	777 *72*	67,575 *7,701*	(1,605)	201	loss	4,105	428	Yes	1969	Home health-care services
84	77	**Newport Pharmaceuticals Int'l.** (Newport Beach, CA)	774 *72*	10,762 *1,231*	1,359	(677)	12.6	135	39	Yes	1970	Mfr. antiviral drug compounds
85	☐	**Alaska Diversified Resources** (Anchorage, AL)	757 *71*	5,485 *640*	293	47	5.3	34	7	Yes	1960	Retail consumer electronics
86	☐	**S.A.L. Cable Communications** (Melville, NY)	745 *70*	18,376 *2,175*	754	23	4.1	70	15	No	1974	Supplier parts & materials for cable TV systems
87	66	**Minnetonka** (Chaska, MN)	739 *70*	96,664 *11,525*	1,225	1,243	1.3	592	208	Yes	1964	Mfr. personal care products
88	☐	**Kyle Technology** (Roseburg, OR)	736 *70*	4,633 *554*	762	42	16.4	87	20	No	1976*	Mfr. pacemaker terminals, connectors
89	97	**C3** (Reston, VA)	729 *70*	32,536 *3,927*	4,962	751	15.3	235	50	No	1968	Supplier customized mini-computer systems
90	60	**Hurco Manufacturing** (Indianapolis, IN)	712 *69*	44,213 *5,446*	2,142	545	4.8	433	111	No	1968	Mfr. machine tools
91	☐	**HBO & Co.** (Atlanta, GA)	698 *68*	29,088 *3,646*	3,015	412	10.4	253	46	Yes	1974	Hospital information services
92	☐	**EnerServ Products** (El Paso, TX)	697 *68*	71,285 *8,947*	8,236	137	11.6	500	8	No	1976*	Supplier casing/tubing for oil & gas wells
93	118	**CPT** (Eden Prairie, MN)	681 *67*	101,344 *12,982*	12,516	1,303	12.4	1,274	221	No	1971	Mfr. word-processing systems
94	☐	**Ferrofluidics** (Nashua, NH)	675 *67*	5,056 *652*	407	68	8.1	103	17	Yes	1968	Mfr. ferrofluidic seals & magnetic fluids
95	☐	**Compucorp** (Los Angeles, CA)	669 *67*	17,901 *2,329*	722	223	4.0	220	57	No	1968	Mfr. desktop computers
96	68	**Team** (Houston, TX)	666 *66*	38,959 *5,086*	3,312	378	8.5	750	400	Yes	1973	Oilfield & energy conservation services
97	104	**Microdyne** (Ocala, FL)	619 *64*	29,019 *4,037*	4,085	242	14.1	550	100	Yes	1967	Mfr. telecommun. systems
98	121	**Service Fracturing** (Pampa, TX)	617 *64*	16,884 *2,354*	2,708	192	16.0	160	30	Yes	1973	Oilfield services
99	107	**North American Watch** (New York, NY)	598 *63*	74,127 *10,618*	5,793	484	7.8	316	45	No	1961	Importer/distributor watches
100	95	**Matrix** (Northvale, NJ)	592 *62*	25,952 *3,750*	2,678	(334)	10.3	348	86	Yes	1956	Mfr. med. diagnostic syst. & graphic recorders

1-Estimate (12/31 closing, fig. unavailable at press time) 2-Nine-month fig. *Predecessor and managerial computer line, the Apple III, before manufacturing bugs had been ironed out. When it was discovered in the field that prospective customers were being sent scurrying, marketing timetables were thrown off, and Apple stock wilted to its low. But Markkula explains that it was simply a matter of bad judgment in thinking that dealers could act as a quality control mechanism. "We tried to use our dealers to insure that we had a good product," Markkula explains. "We assumed that if there was a problem, they would tell us about it, and we could correct it before it got to customers. But it didn't work that way. It took us a year to turn the negative impression around."

A central element in the Apple growing plan is designed around having the smallest number of employees producing the largest amount of goods, a condition Apple accomplishes largely through subcontracting. So far, growth in this area is on an upswing, too. In 1977, 10 employees averaged about $77,000 in sales each; in 1981, each of 2,400 employees averaged $139,500.

With figures like these, Apple obviously no longer is small potatoes (it expects to make the *Fortune 500* at the end of fiscal 1982). As the business gets bigger, Markkula notes, the problems become quite different. From the comfortable bedroom-and-garage of its infancy, Apple has grown into a corporate adult with all the attendant problems. The part that feels the loss of innocence first, he says, is management. Coordination has become much more complex; it's harder to keep team effort going. "Good management is difficult to find at *any* level," reflects Markkula, "whether it's at IBM, Apple, or XYZ Real Estate down on the corner."

Right now, Apple is feeling no growing pains, but Markkula views the future realistically: The spurt phase is winding down. Now Apple has to maintain a share of the market, and look to be first with another, perhaps not yet revealed, product. Each with nearly 25% of the total, Tandy Corp. and Apple are neck-and-neck in a personal-computer industry that is expected to tally over $2 billion in sales this year. By the end of 1985, experts foresee a $5-billion to $8-billion market worldwide. Apple is holding its own. Sales for the first quarter of fiscal 1982 (ending December 25, 1981) exceeded $100 million for the first time. In the spirit of the season, rejoicing management gave employees an extra week of paid vacation.

One problem Apple could conceivably face in the near future is pressure on prices. Already several personal computers are drastically lower priced than Apple's. Commodore Business Machines Inc. of Valley Forge, Pa., expects to introduce a budget machine that will be, at least in part, Apple-compatible. Osborne Computer of Haywood, Calif., has a low-priced portable unit. Franklin Computer of Pennsauken, N.J., has announced a machine that will accept Apple software and Apple peripherals. Undoubtedly there are others in the wings, each hoping to bite into Apple's share. Many won't be able to boast the capabilities, software, or distribution of the Apple line, but as the various entrants jockey for position, prices could tumble as they have in other sectors of consumer electronics.

Nonetheless, Markkula expects Apple to be able to keep pace with the market and perhaps gain a little within it. "We're not looking to triple our share," he admits. "That's not logical. The industry is too large and diversified." With the powerful Apple III now straightened out and undergoing test marketing, and an impressive list of peripherals and software to back it up, it's on to the next. That, reports have it, is code-named "Lisa," Apple's most-powerful-yet machine, designed for data- and word-processing functions and graphics editing. Beyond that, Markkula is mum. But he did not disagree when asked if networking—the interconnection of terminals, programs, and peripherals to optimize cost-effectiveness of equipment—might be the coming thing. And if Apple partakes proportionately in the predicted fivefold increase in personal computer sales, by 1985 it will be grossing over $1.5 billion.

Wall Street, however, remains unconvinced. As the spring of '82 approached, Apple stock was still dawdling at less than half its high of last year. Perhaps it simply had gotten swept along in the out-rushing tide that did in just about every stock remotely connected with technology. At least Markkula thinks so. "I'm surprised that there wasn't more selectiveness in what has happened to the market," he says. "Just because one company has problems doesn't mean that they can be applied to all the others. Each company is unique and different."

Everything about Apple, from its uncommon birth, to the superslick magazine it puts out for owners, to the name itself, has always been different. When you're born to grow, you'd better be.

WHERE THE FAST GROWTH IS...BY INDUSTRY

Here's a ranking of the 1982 INC. 100 companies by industry. While Apple Computer emerges as the overall front-runner, having multiplied its sales 432.5 times in the past five years, the 15 computer manufacturers among the INC. 100 are runners-up to a trio of women's sportswear producers. Other leading industries include fast food, energy, cable TV, and data communications.

Industries and companies are ranked by five-year sales multiples. As a group, for example, the three companies in the apparel industry have multiplied their sales 22.9 times since 1977, followed by those in the computer business at 19.4 and the food service field at 15.0. The miscellaneous category includes leaders in the manufacture of high-technology adhesives, machine tools, and video games.

Industry/INC. 100 company
(5-year sales multiple)

1. **Apparel** (22.9)
    Bio-Medical Sciences (72.6)
    Chemold (21.7)
    Liz Claiborne (15.8)
2. **Computers & related products** (19.4)
    Apple Computer (432.5)
    Vector Graphic (62.0)
    Bedford Computer (40.9)
    Tandon (39.8)
    Lexidata (28.6)
    Tandem Computers (27.1)
    Intertec Data Systems (15.6)
    Dysan (13.8)
    Printronix (12.2)
    Cado Systems (10.8)
    Triad Systems (10.8)
    Intergraph (9.9)
    Cray Research (8.9)
    Intelligent Systems (8.8)
    Compucorp (7.7)
3. **Food service & processing** (15.0)
    Taco Charley (19.9)
    Creative Foods (16.8)
    Sea Galley Stores (13.7)
4. **Oil, gas & minerals** (13.4)
    Gulf Energy (37.7)
    Sage Energy (32.6)
    Sterling Oil of Oklahoma (24.8)
    Nupec Resources (23.1)
    Tomlinson Oil (12.5)
    Oxoco (11.7)
    Texas Energies (10.6)
    Saxon Oil (10.2)
    Jefferson-Williams Energy (9.8)
    Aracca Petroleum (9.4)
    Seneca Oil (9.1)
5. **Cable TV systems & services** (13.1)
    Heritage Communications (15.4)
    AM Cable TV Industries (11.8)
    S.A.L. Cable Communications (8.4)
6. **Data processing & software** (11.6)
    Flare (79.0)
    ASK Computer Systems (43.2)
    Computer Associates Int'l (14.9)
    Computer Designed Systems (14.4)
    David Jamison Carlyle (9.1)
    C3 (8.3)
7. **Data communications, scanners & word processing** (10.9)
    Micom Systems (40.6)
    Inter-Tel (26.2)
    NBI (25.3)
    Network Systems (20.1)
    Symbol Technologies (10.2)
    Interface Mechanisms (9.4)
    Paradyne (8.8)
    CPT (7.8)
    Microdyne (7.2)
8. **Petroleum industry products & services** (10.6)
    Seisdata Services (66.6)
    Seal Fleet (43.9)
    Sterling Pipe & Supply (23.3)
    Barton Valve (11.4)
    Pengo Industries (10.9)
    Geophysical Systems (10.8)
    Amarco Resources (10.3)
    Petroleum Equipment Tools (9.5)
    Blocker Energy (9.4)
    EnerServ Products (8.0)
    Team (7.7)
    Service Fracturing (7.2)
9. **Medical/health products & services** (10.3)
    Electro-Biology (112.8)
    Nutri/System (20.5)
    HemoTec (19.0)
    Healthdyne (16.1)
    Omnimedical (10.8)
    Health Extension Services (10.0)
    Nuclear Pharmacy (9.6)
    Key Pharmaceuticals (9.2)
    Immuno Nuclear (9.1)
    Quality Care (8.8)
    Newport Pharmaceuticals (8.7)
    Kyle Technology (8.4)
    HBO & Co. (8.0)
    Matrix (6.9)
10. **Miscellaneous** (13.2)
    Chemical Investors (42.8)
    RSI (41.0)
    Air Florida (38.9)
    Int'l Game Technology (21.8)
    Magnetic Head (19.9)
    Flight Transportation (18.1)
    M.D.C. (16.9)
    Centuri (16.8)
    Nuclear Support (15.3)
    Pacer Technology & Resources (14.5)
    Royalpar Industries (12.9)
    Shopsmith (12.7)
    Miller Tech. & Communications (10.9)
    Swanton (10.8)
    Andersen 2000 (10.7)
    Majestic Electro Industries (10.0)
    Machine Technology (9.6)
    Reeves Communications (9.1)
    Commodore (8.9)
    Alaska Diversified Resources (8.6)
    Minnetonka (8.4)
    Hurco Manufacturing (8.1)
    Ferrofluidics (7.8)
    North American Watch (7.0)

100

WHERE'S THE CLASS OF '81?

Led by senior stalwarts Cray Research, Tandem Computers, and Tomlinson Oil, 50 of the 1981 INC. 100 companies graduated to the 1982 listing. Of those, 19 moved up in ranking and two retained their positions. The other 29 slipped in the rankings but remain members of an elite club where 1,000% sales growth in the past five years is more the rule than the exception.

What of the 50 companies that failed to qualify this year? Eight did not meet the basic criterion: sales of less than $25 million in the base year 1977. In this category are: Acton, DPF, Intermedics, Nike, Nucorp Energy, Petro-Lewis, Prime Computer, and Rolm—six of which have passed not only the $25-million mark but the $250-million milestone in the past five years.

Twenty-six other 1981 INC. 100 companies grew in the new base period but were off the 590%+ pace of this year's top 100. At least 21 of these clearly rank among the second 100 fastest-growing smaller companies in the United States; including 15 alumni who registered sales gains of more than 400% in the past five years. Pacesetters among the runners-up include Kinder-Care Learning Centers (+579%), CGA Computer Associates (+543%), and Floating Point Systems (+523%).

Twelve companies in last year's ranking closed fiscal 1981 with sales decreases, thus failing to qualify. Notable among those whose 1981 sales tumbled are Chuck Barris Productions, down 91%; Optel, down 48%; and Cobb Resources (last year's leader), off 44%.

The remaining four companies have created headlines representing good news and bad—mergers, litigation, and bankruptcy. Having relinquished their independence to merge with larger companies, DSI and Delhi International Oil no longer qualify for the INC. 100. DSI merged with Anacomp (an INC. 100 company in 1979–80), and Delhi has been absorbed by CSR Ltd., an Australian conglomerate.

Meanwhile, Data Access Systems is entangled in setbacks that include severe discrepancies in its 1977–81 financial statements, conviction of its former chief executive officer on fraud charges, and default on its loan agreements. At press time, the firm was scrambling to arrange new credit terms, scale back its staff, and forge a comeback.

Finally, the Class of '81 is not without a casualty. Barraged by creditor demands, Pittsburgh-based FSC Corp. (No. 32 last year) plunged into bankruptcy last August.

WHAT IT TAKES TO MAKE THE INC. 100

Companies are ranked according to their percentage increase in sales during the last five years (1977–81). To be included in the INC. 100, each company must meet these criteria:

1. The company is an independent, publicly held corporation in a manufacturing, mining, or service industry. Utilities, banks, insurance companies, and other financial institutions are excluded.
2. The company was publicly held as of December 31, 1981.
3. The company shows an operating/sales history of at least five years, with an increase in its fiscal 1981 closing figure. Firms showing growth in the 1977–81 base period but a sales decline in the last year are excluded.
4. The company's 1977 sales were at least $100,000 but less than $25 million.

Sales and income figures are gathered from 10-Ks, prospectuses, annual reports, and various data bases and directories. Additional information is collected from stock reports, trade magazines, and general business publications. By applying the four criteria above, as well as a five-year growth rate of at least 500 , INC. pared the number of companies that potentially qualified for listing from 11,000 to less than 200.

Telephone interviews were conducted with corporate executives to verify the figures, and an editorial team led by senior editor Bradford W. Ketchum, Jr., and assistant editor Carol Torres then selected the 1982 INC. 100.

THE INC. 100 PROFILE

No. of firms by industry	
Manufacturing	53
Services	36
Mining (including oil & gas)	11
Total sales ($ billion)	$5.0
Percent change (1977-81)	+1,247%
Percent change (1980–81)	+77%
Total net income ($ million)	$404.8
Percent change (1977–81)	+3,846%
Percent change (1980–81)	+107%
Mean sales in 1981 ($ million)	$28.7
Mean sales in 1977 ($ million)	$1.7
Comp. average annual sales growth (1977–81)	
Total	92%
Range	62%–356%
Mean	84.5%
Net income as % of sales	
Range	0.6%–22.6%
Mean	8.9%
No. acquiring other firms (1977–81)	45
No. incorporated since 1972	56
Total no. of employees	
1981	62,597
1977	8,853
Percent change (1977–81)	+607%

TOP 10 PERFORMERS: HOW PRODUCTIVE, HOW PROFITABLE?

1981 Productivity*
(Sales per employee)

Rank	Company (INC. 100 rank)	Sales per employee
1.	Sterling Pipe & Supply (22)	$1,454,301
2.	Majestic Electro Industries (64)	719,143
3.	David Jamison Carlyle (77)	376,650
4.	Liz Claiborne (36)	332,852
5.	Andersen 2000 (59)	325,867
6.	S.A.L. Cable Communications (86)	262,514
7.	Centuri (33)	245,840
8.	North American Watch (99)	234,579
9.	Flight Transportation (31)	177,457
10.	Minnetonka (87)	163,284

Excludes capital-intensive energy developers or companies whose primary business is leasing or real estate.

1981 Profitability
(Net income as % of sales)

Rank	Company (INC. 100 rank)	Net income % of sales
1.	Int'l Game Technology (24)	22.6
2.	Sage Energy (16)	22.4
3.	Intertec Data Systems (37)	21.7
4.	Immuno Nuclear (78)	21.1
5.	Petroleum Equipment Tools (70)	20.0
6.	Oxoco (50)	19.6
7.	Barton Valve (51)	19.4
8.	Nutri/System (26)	18.8
9.	Nupec Resources (23)	18.7
10.	Seal Fleet (7)	18.6

Investing in Growth Companies

THE INC. 100: WHAT GOES UP MUST COME DOWN

This year's INC. 100 average headed south along with the rest of the stock market indexes. But all things considered, it could have been worse.

By Wall Street standards, anyway, the Second Industrial Revolution that many have thought would be sparked by small-company, big-growth innovation has not yet taken hold. All the major averages declined significantly since last March, when INC. first pitted its annual compilation of the country's fastest-growing public companies against the Dow Jones Industrials, the Standard & Poor's 500, the American Exchange Index, and the NASDAQ Composite. At that time, the table showed that the INC. 100 average—a figure arrived at by calculating how $100 invested in each stock would have fared for 12 months—gained an enviable 76%. That was double its closest rival, the NASDAQ Composite, at 38%. The Amex Index was up 27%, the S&P 500 was up 22%, and the creaky old Dow a mere 19%.

This time around, the tables have turned. INC.'s new gathering of the fastest growers turned in the worst collective performance. But, taken in the context of a recessionary cycle, it wasn't *that* bad. Where last year's 100 list soared head and shoulders above the other four averages, this year it is simply bringing up the rear of a bedraggled lot. For that dubious distinction, it dropped below the Amex by a single percentage point, both indexes being sprinkled liberally with oil stocks, which fared particularly badly in the 12-month period. Even the conservative Dow and the S&P were well into double-digit declines. Perhaps the biggest surprise—if there are any surprises—comes in the breadth of the difference between NASDAQ and INC., since both are largely made up of the same breed of modestly capitalized, often high-tech smaller company. NASDAQ is the exchange of choice (or necessity) of no less than 90 of this year's INC. group. But after outstripping the NASDAQ index by double last year, INC. nearly doubled NASDAQ's loss this year. Again, the unusual preponderance on INC.'s list of energy-related issues—a group whose rapid revenue growth is destined to be slowed by recent oil oversupply—would help to explain INC.'s downside proclivity. Despite this reversal of fortunes, for both years taken together INC. is still ahead by a healthy 25%. This two-year return approximates that of a money fund, but it would be far more breathtaking for an investor.

RELATIVE MARKET PERFORMANCE OF THE INC. 100

	3/10/81	3/10/82	% Loss
INC.	100	73.36	27
Dow Jones Industrials	972.66	804.89	17
Standard & Poor's 500	130.46	109.41	16
American Exchange Index	336.94	249.19	26
NASDAQ Composite	199.03	170.42	14

In any event, for two apparent reasons, such comparisons are academic. One is that the 1982 INC. enumeration is different from last year's version. Forty-seven entries are on the list for the first time (no fewer than 26 of which went public during the 12 months). The other reason is that, factually speaking, the INC. 100 could not have been invested in last March, since no one could have known then which companies would be included.

Unlike some indexes, such as the DJI, which "weight" certain components more or less heavily than others, INC.'s is a true average of how each of its 100 stocks performed. Here's how it was arrived at: The mean bid (or, in the case of the 10 NYSE and Amex stocks, the close) was tabulated between the month's high and low for March 1981 and for March 1982 (at press time). INC. then "bought" the number of shares and fractional shares that it could have purchased with $100 for the March 1981 mean, and "cashed out" at the March 1982 mean. The result is shown in the right-hand column. The total was then added, and divided by 100 to get the average. Brokerage commissions were not considered, nor were cash dividends. Most of the INC. 100, because of their nature, are not cash payers. But 10 of them voted stock splits or stock dividends, down from 32 last year.

That the INC. 100 can gain 76% one year and lose 27% the next is not particularly puzzling. As myopic as the stock market may often seem, Wall Street looks well beyond expanding sales and fears the problems that a recession can bring to small businesses. Although a company may remain fiscally sound, chances are that it will be touched to some degree by the general dispirit and downturn of a troubled economy. The market simply doesn't like taking such chances, no matter how dynamically earnings may be growing.

It ought to be some encouragement, then, that 21 members of the class of '82 managed to show a stock-market profit. They are, for the most part, young companies with little experience so far in facing adversity. The list's largest gainer—Ferrofluidics Corp. of Nashua, N.H.—is just such a company. Only 13 years old and newly public, Ferrofluidics has experienced soft earnings periods. With many sophisticated technology products under development, the company says, this performance is in accordance with its

Unlike some indexes, such as the DJI, INC.'s is a true average of how each of its 100 stocks has performed.

business projections. The company has kept functioning well, has quietly managed to come up with financing when needed (see "R&D Partnerships Come of Age," INC., March) and seems quite untouched by the fiscal turmoil taking place outside its doors. If the Second Industrial Revolution is indeed just around the corner, it may well be that such fearless youths will lead it. In the meantime, for those whose portfolios are replete with last year's high-fliers, it's well to remember that what went down can also go up—and that the volatility of stocks like those represented on the INC. list can turn frowns into smiles in a matter of weeks.

In the long run, fundamentals matter and, if the sales growth records turned in by these companies mean anything, the future should be brighter than the immediate past. —*R. Mamis*

INC. 100 MARKET PERFORMANCE

1982 Rank	Company (symbol)	Mean High/Low 3/81	Mean High/Low 3/82	$100 Worth
1	**Apple Computer** (AAPL)	$24.19	$16.79	$69.41
2	**Electro-Biology** (EBII)	24.00	20.13	84.88
3	**Flare** (FLAR)	3.25[a]	2.63	80.92
4	**Bio-Medical Sciences** (BMSC)	2.06	1.31	63.59
5	**Seisdata Services** (SDAT)	7.25[b]	5.25	72.41
6	**Vector Graphic** (VCTR)	14.38[b]	10.63	73.92
7	**Seal Fleet** (SEALA)	5.44	2.25	41.36
8	**ASK Computer Systems** (ASKI)	13.44[b]	12.38	92.11
9	**Chemical Investors** (CHML)	3.63	2.50	68.97
10	**RSI** (RSIC)	2.13	2.00	93.90
11	**Bedford Computer** (BEDF)	8.44[c]	8.63	102.25
12	**Micom Systems** (MICS)	34.50[d]	21.50	62.32
13	**Tandon** (TCOR)	20.13	25.13	124.84
14	**Air Florida System** (AIRL)	11.88	5.00	42.09
15	**Gulf Energy** (GFEC)	2.00	0.44	22.00
16	**Sage Energy** (SAG)[A]	24.56	10.31	41.98
17	**Lexidata** (LEXD)	14.13[e]	9.44	66.81
18	**Tandem Computers**[1] (TNDM)	23.63	23.38	98.94
19	**Inter-Tel** (INTL)	21.63	10.41	48.13
20	**NBI** (NBI)[N]	24.75	23.63	95.47
21	**Sterling Oil of Oklahoma** (SOOK)	1.75	0.75	42.86
22	**Sterling Pipe & Supply** (PIPE)	13.50[f]	4.13	30.59
23	**Nupec Resources** (NUPC)	0.58	0.30	51.72
24	**Int'l Game Technology** (IGAM)	12.31[b]	13.56	110.15
25	**Chemold** (–)	1.00[B]	1.50[B]	150.00
26	**Nutri/System** (NUTR)	22.50	19.38	86.13
27	**Network Systems** (NSCO)	18.06	16.31	90.31
28	**Magnetic Head** (MHED)	0.34	0.19	55.88
29	**Taco Charley** (TACC)	1.19[a]	0.81	68.07
30	**HemoTec** (HEMO)	9.38	6.25	66.63
31	**Flight Transportation**[2] (FTCC)	5.70	8.00	140.35
32	**M.D.C.** (MDCO)	3.88	3.94	101.55
33	**Centuri** (CENT)	6.44	6.50	100.93
34	**Creative Foods** (–)	1.25[B]	1.00[B]	80.00
35	**Healthdyne** (HDYN)	18.50[e]	19.50	105.41
36	**Liz Claiborne** (LIZC)	23.00[d]	25.75	111.96
37	**Intertec Data Systems** (IDC)[A]	23.56[f]	16.94	71.90
38	**Heritage Communications** (HCOM)	14.94	8.88	59.44
39	**Nuclear Support Services** (NSSI)	9.50[e]	7.75	81.58
40	**Computer Associates Int'l** (CASI)	13.50[e]	12.63	93.56
41	**Pacer Technology & Resources** (PTRI)	5.56	1.63	29.32
42	**Computer Designed Systems** (CDSI)	2.94[e]	2.50	85.03
43	**Dysan** (DYSN)	20.00	13.50	67.50
44	**Sea Galley Stores** (SEAG)	14.69	8.44	57.15
45	**Royalpar Industries** (–)	3.00[B]	4.00[B]	133.33
46	**Shopsmith** (SHOP)	10.38	7.13	68.69
47	**Tomlinson Oil** (TLOC)	9.81	2.56	26.10
48	**Printronix** (PTNX)	24.38	18.75	76.91
49	**AM Cable TV Industries** (AMTV)	23.50	4.56	19.40
50	**Oxoco** (OXCO)	15.06	6.94	46.08
51	**Barton Valve** (BART)	25.25[d]	17.38	68.83
52	**Miller Tech. & Communications** (MECC)	10.00	7.81	78.10
53	**Pengo Industries** (PGO)[N]	26.25	11.00	41.90
54	**Swanton**[3] (SWTN)	18.00	6.00	33.33
55	**Cado Systems**[4] (CADO)	21.42	9.88	46.13
56	**Omnimedical** (OMNI)	16.13	5.50	34.10
57	**Triad Systems** (TRSC)	29.25	17.00	58.12
58	**Geophysical Systems** (GSCO)	24.75[d]	10.25	41.41
59	**Andersen 2000** (ANDN)	13.25	8.13	61.35
60	**Texas Energies** (TXEN)	7.38	4.69	63.55
61	**Amarco Resources** (AMAR)	5.56	2.19	39.39
62	**Saxon Oil** (SAXO)	40.75	6.56	16.10
63	**Symbol Technologies** (SMBL)	9.69	5.25	54.18
64	**Majestic Electro Industries**[5] (MJEL)	1.60	0.81	50.63
65	**Health Extension Services** (HELP)	13.38	6.06	45.29
66	**Intergraph** (INGR)	29.38[f]	21.88	74.47
67	**Jefferson-Williams Energy** (JWEC)	8.38[h]	5.50	65.63
68	**Machine Technology** (MTEC)	4.00	3.13	78.25
69	**Nuclear Pharmacy** (NURX)	7.94	7.56	95.21
70	**Petroleum Equipment Tools**[6] (PTCO)	24.06	16.63	69.12
71	**Blocker Energy** (BLK)[A]	26.56	7.69	28.95
72	**Aracca Petroleum** (ARAC)	7.50	2.56	34.13
73	**Interface Mechanisms** (INTR)	17.13	6.25	36.49
74	**Key Pharmaceuticals**[7] (KPH)[A]	19.42	20.44	105.25
75	**Reeves Communications**[8] (RVCC)	24.50	30.25	123.47
76	**Seneca Oil** (SNCA)	18.44	5.00	27.11
77	**David Jamison Carlyle** (DJCC)	5.00	5.00	100.00
78	**Immuno Nuclear**[9] (INUCC)	7.88	11.88	150.76
79	**Commodore** (CCT)[A]	3.19	3.38	105.96
80	**Cray Research** (CYR)[N]	36.13	29.19	80.79
81	**Paradyne** (PDN)[N]	35.31	32.50	92.04
82	**Intelligent Systems** (INTS)	17.50	17.88	102.17
83	**Quality Care** (QUCAC)	4.31	3.19	73.96
84	**Newport Pharmaceuticals Int'l** (NWPH)	12.19	5.56	45.61
85	**Alaska Diversified Resources** (ADRI)	1.13[i]	1.44	127.43
86	**S.A.L. Cable Communications** (SALC)	15.06[d]	6.13	40.70
87	**Minnetonka**[10] (MINL)	5.16	3.38	65.50
88	**Kyle Technology** (KYLE)	6.88[d]	9.06	131.69
89	**C3** (CCCI)	31.50	13.00	41.27
90	**Hurco Manufacturing** (HURC)	20.38	12.38	60.75
91	**HBO & Co.** (HBOC)	25.75[d]	29.13	113.13
92	**EnerServ Products** (ESV)[A]	16.75[f]	8.88	53.01
93	**CPT**[11] (CPTC)	13.96	13.44	96.28
94	**Ferrofluidics** (FERO)	1.91[c]	3.25	170.16
95	**Compucorp** (CCUP)	7.94	8.50	107.05
96	**Team** (TEAM)	26.00	7.63	29.35
97	**Microdyne** (MCDY)	21.63	11.94	55.20
98	**Service Fracturing** (SERF)	23.00	12.25	53.26
99	**North American Watch** (–)	16.00[B]	26.00[B]	162.50
100	**Matrix** (MAX)[A]	34.00	17.94	52.76

All stocks traded over-the-counter except as noted. (N) New York Stock Exchange (A) American Stock Exchange (a) First public Nov. 1981 (b) First public Oct. 1981 (c) First public July 1981 (d) First public June 1981 (e) First public Dec. 1981 (f) First public April 1981 (g) First public May 1981 (h) First public Sept. 1981 (i) First public Aug. 1981 (B) Best available quote.

(1) 3:1 split, 7/81 (2) 5% div., 2/82 (3) 25% div., 7/81 (4) 50% div., 6/81 (5) 25% div., 8/81 (6) 100% div., 6/81 (7) 3:2 split, 6/81 (8) 50% div., 7/81 (9) 100% div., 1/82 (10) 3:1 split, 2/81 (11) 3:1 split, 7/81

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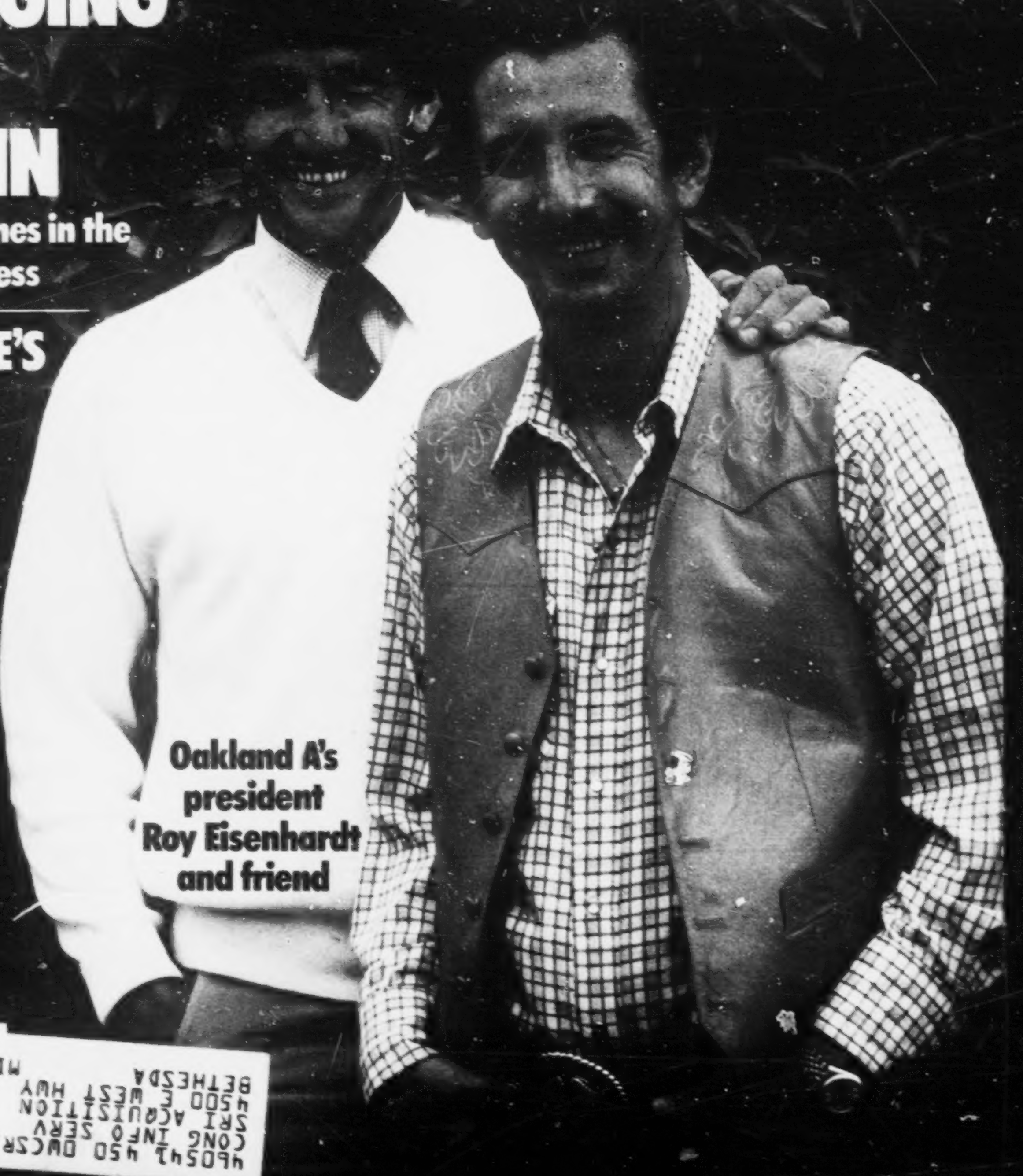

Oakland A's president Roy Eisenhardt and friend

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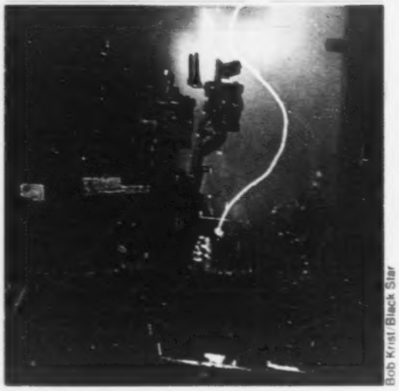
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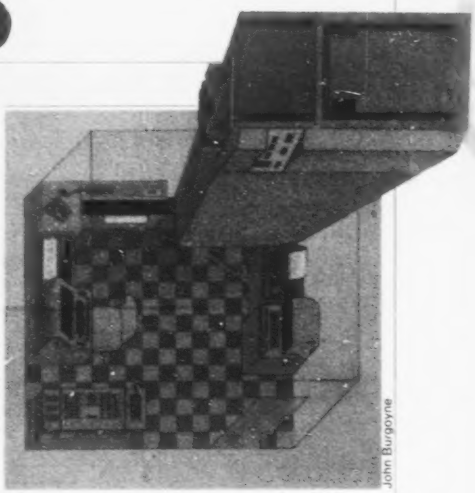
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David Mendelsohn

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INC. Special Report

YOU AND YOUR ATTORNEY

The relationship can be brief and hostile, or long and harmonious. Here's how to make it the latter.

By Bradford W. Ketchum, Jr.

Many small businesses consider the use of professional advisers a sign of extravagance. The truth is, it all depends on need. And the need for competent advice is rarely clearer than in matters involving law. Good legal services can be used to great advantage. Or they can be wasted. The difference is up to the client.

You have the right to remain silent, as they say, but that's a good way to insure a relationship with your lawyer that is more prodigal than productive. If your company is not getting its money's worth from its attorney, if you feel that you're being overcharged or underrepresented, it's up to you to present the evidence. If you don't question your attorney's advice or fees, he or she has the right to assume that you understand and accept both.

Although the small business executive and the typical lawyer consider themselves in different professional leagues, the two have much in common. Both operate in an independent sector of the economy, and neither has a sheltered market. Both place great importance on the freedom to pursue their own objectives and to choose their own customers and clients. And both face the usual problems of running a business—reducing paperwork, billing delinquent accounts, resolving personnel problems, maintaining facilities, and deciding whether to grow or to remain relatively small. Yet the relationship between small businesspeople and attorneys is often antagonistic. Lofty professional and lowly client often are paired, one to grapple with the problem while the other grumbles about the fee.

But small businesses and law businesses are vital to each other. A recent INC. study shows, for example, that more than 9 out of 10 (94%) small companies regularly rely on outside legal counsel, while close to 9 out of 10 (88%) attorneys consider small business clients important to their practices.

To help small companies improve their rapport with the legal profession, INC. surveyed some 5,000 small business executives and over 5,000 practicing attorneys (see "How We Reached Our Verdict," page 56). The results of the study provide five guidelines on how to be a better client and how to make your attorney a better adviser.

1. Treat your attorney as an insider. If your company is like most small businesses, its two most important outside advisers are its accountant (INC., March, page 81) and its attorney. Depending on company size and business circumstances, one of them probably holds the edge as your *chief* outside adviser. To build good working relationships, however, you should treat them equally—as insiders.

Since the need for legal advice is not as predictable or as regular as the need for accounting services, keeping your attorney on the inside track takes greater effort. It requires frequent and candid communication with your legal counsel. Too often, small companies call their lawyers only when it's time to draw up a contract or when litigation is imminent. Yet providing your lawyer with timely and cumulative information should be the rule. For example, copies of management memos regarding the current concerns or status of your business should be sent to your attorney as background for his files. If you hold a special planning meeting to discuss goals or future directions, invite your attorney to attend. As a confidant and participant, your attorney will be in a better position to provide advice and to respond readily

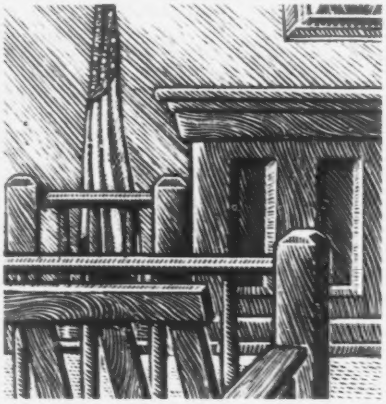
Illustrations by Doug Smith

to your company's legal needs.

Very few small companies—only 2%—employ their own full-time, in-house attorneys. In these cases, the legal adviser is literally an insider, generally functioning as president, vice-president/general counsel, or secretary/treasurer. Since a house counsel is impractical for most small businesses, many have discovered the next best step—tapping their attorneys to serve on their boards of directors. Directorship formalizes the attorney's status as an insider.

INC.'s study shows that the use of lawyers as directors is related to company size. About 10% of the companies with sales of less than $1 million enlist their attorneys for board duty. The figure rises to 20% among companies in the $3-million-to-$5-million category and to 30% in companies with sales of $5 million to $25 million. Judging from the responses from attorneys surveyed, the legal profession is not averse to director service—61% of them indicated that they currently serve on the boards of smaller clients.

2. Find out how you rate as a client. Small businesses are loyal, if not lucrative, accounts for most law firms. What they may lack in billing size they make up for in their preference for single long-term relationships. Some 68% of the respondents to the INC. survey rely on only one law firm, while 22% employ only two. The use of more than one attorney generally reflects the need for legal specialists rather than divided loyalty or competition. Most of those who employ more than one legal adviser are larger firms whose sales are more than $5 million and whose needs exceed the capabilities of a single general practitioner.



Not only do small companies generally rely on a single source for legal services, they also tend to stick with that source. The majority of the INC. respondents represent older companies founded before 1970. Yet 44% of them report that their present law firm is the *only* one they have ever had. Among those who have switched law firms, three out of four have changed attorneys only once or twice. On average, the survey participants have retained their current legal counsel for more than nine years.

The limited turnover is testimony to the value of retaining competent advisers who know your business. But the loyalty it represents also helps explain why most law firms value small businesses as clients. Small companies account for the majority of the clientele in almost half (48%) of the law firms responding to INC.'s study. Only 1% of the attorneys reported they don't have smaller businesses as clients, and only 11% rate small companies as less important than larger clients.

Most attorneys agree that small companies not only represent a solid customer base but also offer broader potential than many larger clients. For this reason, three out of five law firms now employ full-time small business specialists; on average, the small business legal staff consists of three professionals.

How does your law firm rate small business in general and your business in particular? Is there a sense of loyalty between your company and its legal counsel? Is your attorney responsive to your needs as a small company? Does your law firm intend to expand its small business practice in 1982? Positive answers to such questions indicate your standing as a client and provide the foundation for making a good relationship even better.

3. When you call, make it count. If your company is like most small businesses, you rely on your law firm primarily to draw up contracts and agreements, wrestle with the personal needs of top management, and represent you in litigation. Other common needs for legal counsel involve real estate and insurance problems, estate planning, and matters as mundane as dunning delinquent accounts. Beyond these typical require-

HOW ATTORNEYS ARE USED

	Annual company sales				
	Under $1 mil.	$1 mil.-2.9 mil.	$3 mil.-4.9 mil.	$5 mil.-24.9 mil.	$25 mil. or more
Legal service used (ranked by total mentions)	**Percent of respondents**				
Contracts & agreements	70%	74%	69%	84%	85%
Personal needs of top management	46	58	56	53	38
Formal litigation	34	50	63	61	91
Real estate & insurance matters	32	35	50	51	56
Incorporation	45	34	39	33	24
Estate planning	23	42	48	44	27
Delinquent accounts	20	33	39	34	21
Liability protection	20	17	22	33	41
Copyrights, trademarks, patents	21	19	24	28	38
Mergers & acquisitions	12	14	29	32	47
Employee benefits plans	10	26	19	27	27
Tax planning & review	13	17	22	17	12
Employee stock ownership plan	9	15	10	18	21
Franchising & licensing	13	11	14	14	12
Government-required reports	8	6	6	10	12
Prospectus for public offering	2	1	5	2	18
Labor relations	1	2	2	3	3

The need for legal counsel is obvious when it comes to contracts and lawsuits. But the INC. survey shows that small business managers also rely on company attorneys for personal problems ranging from tax matters to divorce and estate probate. As company size increases so does the need for advice in such areas as liability, mergers, and benefit plans.

PICKING AN ATTORNEY

How small business selects a law firm

Top 10 factors	Percent of respondents
1 Personal contact with members of firm	54%
2 Reputation	40
3 Prior relationship with firm	26
4 Recommended by other clients	15
5 Recommended by banker or accountant	14
6 Location	13
7 Range of services	13
8 Industry expertise	12
9 Fee	3
10 Small business's parent company	2

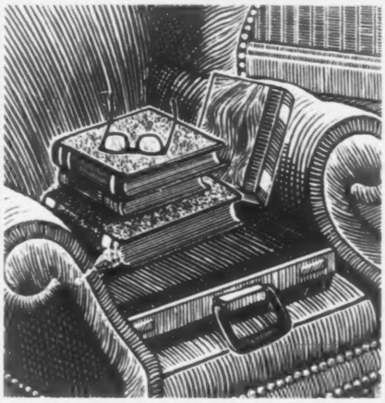
Personal relationships, reputation and references head the list of influences on small businesses' choice of attorneys.

ments, small business's demands for legal advice range from matters involving taxes and patents to labor relations and public offerings.

Maintaining regular communication with your lawyer is important. But how often should you be in touch and how do you make every call count?

The majority (58%) of the companies responding to INC.'s survey talk with their attorneys at least once every 30 days, although the frequency of communication varies widely, depending on company size and circumstances. Among the smallest firms, contact with legal counsel ranges from once a week (10% of respondents) to once every six or seven months (36%). Among larger companies, with sales of $5 million to $25 million, the percentages are almost reversed—33% are in touch with their attorneys at least once a week, while only 11% go beyond the six-month mark without communication.

Good communication with your legal adviser helps create the kind of rapport that prompts him to call *you*, for example, when he spots a change in legislation that might affect your business. Assuming that you don't have immediate need for counsel, contact once a month should suffice. A personal visit is preferable, but a phone call will do. Plan to cover at least three or four items or questions that you have jotted down and accumulated during the month. The continuity of relationship will be valuable in resolving routine matters but will count most when your need for legal advice is immediate and unexpected.



4. Forget the dollars, worry about the sense. Regardless of how smooth the relationship may be, legal fees are a perpetual burr for most small businesses. The problem is a practical one, with two sides and a single solution.

Clients often don't understand exactly what services their attorneys are performing and why they cost so much. They are mindful, however, that the meter is always running. In turn, attorneys are deficient in making clear to their clients just when they'll be billed, what the charges will be, and why. As a result, their bills always seem too late, too large, and too vague in terms of time spent and work done.

The solution is to establish a clear understanding about cost and then put it in writing. The written agreement should specify what services will be performed, what the fees and reimbursable expenses will be, and how you will be billed, including frequency, itemization, and—if applicable—progress summaries. As a matter of practice, several dos and don'ts apply. Don't ever hesitate to call your attorney. But when you ask him to do something—whether it's a request to attend a management meeting or send a dunning letter to a customer—don't expect him to do it for nothing. Do ask for an estimate on specific jobs, but don't continually try to negotiate fees.

How do most small businesses pay their attorneys, and what's the typical tab? Almost 7 out of 10 respondents to the INC. survey compensate their lawyers on an hourly basis; the rest rely on negotiated fees, flat rates, and retainers. Not surprisingly, the use of nonhourly payment methods directly relates to company size. Flat fees, for example, are generally found among the smallest companies, while retainer agreements are more common among the largest firms.

While annual legal costs among the survey respondents range from $150 to $75,000, the majority (63%) of companies manage to keep their legal fees under $5,000. Depending on company size, average annual legal expenses range from about $4,300 to nearly $43,000. Figures from the attorneys surveyed corroborate the data. Some 93% of the lawyers reported that small companies pay for their services on an hourly basis. While the average annual legal fee paid by their small business clients is $6,948, 55% of these clients pay less than $5,000.

Do small businesses enjoy any special break in rates? Not among most law firms. However, 17% of the attorneys surveyed offer what amounts to special concessions for small companies. Such breaks take the form of lower hourly rates, running as much as 30% less than larger clients pay, discounts of up to 25% for start-ups or repeat business, and deferred payment terms.

(continued on page 56)

HOW LAWYERS WOULD CHOOSE A LAW FIRM

	Criteria ranked most important (What a small company should look for)	Percent of attorneys*
1	**Specific expertise** (Experience in your area of need)	41%
2	**Overall competence** (Quality of advice, problem-solving ideas, negotiating skills, etc.)	39
3	**Fee** (Reasonable & affordable charges)	32
4	**Small business knowledge** (Experience with similar companies)	29
5	**Timely service** (Responsiveness, prompt turnaround)	28
6	**Personal attention** (Compatibility & willingness to become involved in your business)	25
7	**Reputation** (Recommendations of other clients)	22
8	**Availability** (Accessibility of top partner/attorney)	21
9	**Range of services** (Diversity & depth of staff)	17
10	**Importance of client to firm** (Client list & interest in small companies)	6

*Total exceeds 100% due to multiple responses.

Advice from the advisers: Look for competence, reasonable fees, and small business savvy in selecting a law firm. Other factors that should be considered are the firm's ethical standards, track record, and partner credentials.

HOW ATTORNEYS SIZE UP SMALL BUSINESS

Typical client (annual sales $)	Percent of respondents
Under 500,000	17%
500,000-999,999	26
1 mil.-1.9 mil.	26
2 mil.-2.9 mil.	13
3 mil.-4.9 mil.	4
5 mil.-9.9 mil.	8
10 mil. or more	6

To most attorneys, small businesses are companies whose sales are less than $3 million. The typical small business client also has fewer than 50 employees.

5. To find a lawyer, look beyond the local bar. Knowing how to select a lawyer—whether to replace or to reinforce your existing counsel—is part of being a better client. There are various reasons, negative and positive, for switching attorneys. The negative ones range from consistent disagreement and general neglect, to incompetence and exorbitant fees. On the positive side, a change may be in order because your business simply has outgrown your legal counsel's capabilities or your needs have become more complex and require an experienced specialist. In the latter case, your present attorney may even instigate the change for you.

Regardless of the motive, how should the search for another law firm be launched and what criteria should you use for selection? Most larger libraries have a copy of the *Martindale-Hubbell Law Directory*—a national listing of the legal profession. Your local and state bar associations may be a better place to start. And your best source will be the references and recommendations provided by your business peers, accountant, banker, broker, and other advisers.

Based on the responses from small business executives and attorneys who participated in the INC. survey, the chief criteria for choosing a law firm include personal chemistry and accessibility, reputation, expertise in your specific area of need, overall competence, and fees commensurate with services performed. ☐

Bradford W. Ketchum, Jr., is a senior editor at INC.

HOW—AND HOW MUCH—ATTORNEYS ARE PAID

	Annual company sales					
	Under $1 mil.	$1 mil.-2.9 mil.	$3 mil.-4.9 mil.	$5 mil.-24.9 mil.	$25 mil. or more	All respondents
Method	Percent of respondents					
Hourly rate	67%	67%	72%	73%	63%	69%
Negotiated fee	16	17	15	7	6	14
Retainer	7	12	12	21	28	13
Flat fee	12	9	5	7	3	9
Annual legal fee						
Under $1.000	39	15	5	3	–	20
$1.000-$4.999	46	54	44	29	7	43
$5.000-$9.999	6	17	31	18	4	14
$10.000-$19.999	4	8	13	21	19	11
$20.000 or more	5	6	7	29	70	12
Average annual fee	$4.280	$5.370	$7.270	$15.050	$42.590	$8.400

Regardless of company size, most businesses compensate their attorneys by the hour. However, a few smaller companies pay negotiated or flat fees, while some larger firms rely on retainers. Among the smallest companies, annual legal expenses are generally less than $5.000.

THE 10 BIGGEST GRIPES ABOUT ATTORNEYS

Source of dissatisfaction	Percent of respondents
1. Timely service	33%
2. Reasonable & clear fee structure	24
3. Accessibility	23
4. Knowledge of client's business/industry	15
5. Communication & rapport	12
6. Limited staff	12
7. Technical knowledge	10
8. Interest in small business	8
9. Ability to cut red tape & paperwork	8
10. Turnover of professional staff	4

Small businesses' chief complaints about attorneys center on slow response, hefty fees, and inaccessibility of top staff members.

HOW WE REACHED OUR VERDICT

This article is the second in a series of special reports on small business and the professions. It summarizes a national study of smaller companies and their attorneys. The primary research for the report, conducted in December 1981 and January 1982, included two mail surveys supplemented by telephone interviews with a cross section of small business executives and practicing attorneys.

A four-page questionnaire was mailed to a random sampling of 4,995 INC. subscribers, followed by a two-page questionnaire sent to a random sampling of 5,008 attorneys. The latter group included more than 4,800 members of the American Bar Association's corporate law section and small business committee.

Excluding undeliverable, incomplete, and late returns, the net subscriber response rate was 22.1%. Some 993 subscriber returns were tabulated by computer to generate 46 cross-reference summaries. The net response from attorneys was 5.4%, providing 270 valid returns for statistical summaries.

The subscriber respondents represent all 50 states and the District of Columbia, 24% of them with headquarters in the Northeast, 13% in the Southeast, 40% in the Central region, and 23% in the Mountain/Pacific states. Separated into seven industry categories, the majority of respondents are in manufacturing (32%) or wholesale/retail businesses (25%). Other major groups include business services (17%), professional services (13%), and construction/real estate (7%).

The attorney respondents represent 42 states and the District of Columbia; 22% of them are based in the Northeast, 19% in the Southeast, 36% in the Central region, and 23% in the Mountain/Pacific states. While the respondents ranged from sole practitioners to law firms with as many as eight offices and 140 partners, about two out of three represent small law firms with one office and no more than 5 partners.

Other vital statistics of the two respondent groups include the following:

Subscribers (993)	
Avg. annual sales ($ mil.)	$5.1
Avg. number of employees	62
Privately held corporation	84%
Publicly held corporation	6%
Proprietorship	7%
Partnership	3%
Use outside attorney	94%
Attorneys (270)	
Avg. number of partners	10
Avg. number of employees	54
Median number of clients	250
Gen. practice: business law	72%
Gen. practice: litigation	6%
Business and litigation	11%
Specialist	11%

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THE UN-MANAGER

Without ranks and titles, Bill Gore's company has grown to $125 million

HOW TO BARTER FOR VIRTUALLY ANYTHING

WHY QUALITY CIRCLES ARE FLOUNDERING

CONTROLLING EMPLOYEE HEALTH-PLAN COSTS

Gore-Tex
Founder
Bill Gore

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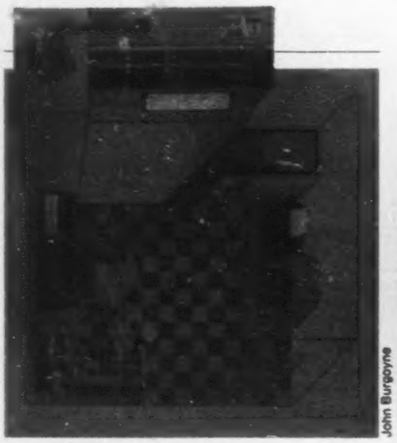

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Fred Ward/Black Star

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Fred Ward/Black Star

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Rx FOR TRIMMING HEALTH-CARE COSTS

Five ways to counter the spiraling cost of employee coverage.

By Annette Kornblum

If health insurance is costing your company from $1,200 to $1,500 per employee annually, you're not alone. Such a tab is typical—and it is bound to grow. But you needn't simply grin and bear the surge in insurance premiums. There are ways to shrink the size of your health insurance bill without compromising the well-being of your employees.

Here are five prescriptions to save you money on health-care costs.

1. Decide whether to provide health coverage and, if so, what type. Should you rely on traditional health insurance through a commercial carrier or offer alternative care through a community health plan? Should you go the "Cadillac" or "Pinto" route? Regardless of what you decide, there will be trade-offs. If you decide that it's unnecessary to provide any health coverage, you won't be alone. In a 1981 survey of INC. subscribers, 21% of the respondents reported that their companies do not carry group insurance. If you provide benefits but opt for alternative health care, such as that offered by the growing number of one-stop health maintenance organizations (HMOs), you may get objections from employees who prefer to see their own doctors.

A "Cadillac" comprehensive plan will cover a substantial share of all hospital expenses, all physician fees, laboratory tests, X rays, and out-of-pocket expenses for prescription drugs, dental treatment, and even psychiatric care. But its cost may be four or five times the cost of a "Pinto" catastrophe-only plan, which is hospital and/or major medical. A company with a low-risk environment and young, healthy workers (i.e., average age under 40) could get by on a less-expensive, higher-deductible plan, while a high-risk company comprised of primarily older workers or those who have a history of illnesses and disability would be better off with a costlier, comprehensive policy.

Annette Kornblum is a freelance writer based in Washington, D.C.

Another key consideration is the maximum "out-of-pocket" expense an employee or family can afford. Under a plan with a $100 deductible plus $400 in co-insurance, or shared cost, the single employee would pay no more than $500 while a family of five could be liable for $2,200 a year because each individual is subject to the full co-insurance amount. If your company's employees are mostly married with families, a dollar limit on family out-of-pocket costs would restrict the liability and ultimately lower the employee's cost dramatically. On the other hand, with the exception of first-dollar (no-deductible) accident expense benefits, adding first-dollar hospital, surgical, and X-ray benefits may end up costing more in premiums than the actual level of benefits.

If your company provides health benefits, is required to pay the minimum wage, and has more than 25 employees living in the service area of a federally qualified HMO, you may be required by law to give employees the option of joining an HMO. HMOs are groups of local health-care providers, including hospitals, that operate on a prepaid principle with few or no deductibles. There are about 250 such organizations in the United States offering comprehensive medical services, generally under one roof. Some employees may prefer one-stop treatment, where they are guaranteed access as well as automatic coverage without having to submit claim forms. In some parts of the country, HMO premiums may be cheaper and even offer more benefits than conventional coverage.

HOW MANY COMPANIES HAVE GROUP INSURANCE?

A recent survey of INC. subscribers shows that 713, or 73%, of the companies that responded carry some form of group insurance, 21% indicated no coverage, and 6% did not specify. Not surprisingly, group health and major medical coverage come out on top.

Type of insurance	Percent of respondents who carry
Health	94
Major medical	80
Life (term)	72
Surgical	67
Accidental death & dismemberment	46
Long-term disability	35
Temporary disability	34
Dental	22
Health maintenance	12
Life (whole)	10

Source: 1981 INC. Financial Survey

2. Shop for a cost-conscious carrier. The discrepancy in price between essentially identical plans can be as much as 20% to 30%. For example, a mail-order company in Washington, D.C., with 14 employees, paid $1,580 in monthly premiums for a group life, health, and major medical plan before switching to another carrier that offered similar benefits—for $4,200 less a year. Because it required less paperwork, the company saved additional money and applied the windfall toward a dental plan and a money market fund, with $800 to spare.

How do you determine who offers the best deal? Comparison shop the way you would on any other business expenditure. Ask other employers in your area and industry who provides their coverage, what kind of services they are getting for the money, and whether they are satisfied. Contact Blue Cross and Blue Shield and commercial health-insurance companies. Ask prospective carriers for a list of references and find out which carriers are most receptive to designing a plan tailored to your company's needs.

Alternatively, check with brokers, agents, and insurance consultants who are familiar with the marketplace. The advantage of having them do the shopping is that they know offerings, know how to read the fine print in policies, and can help you design a benefit package reflecting your needs, within your budget. The trade-off is that you'll have to pay a percentage or fixed fee.

(continued on page 108)

FINANCIAL TACTICS *(from page 106)*

But if your bill is trimmed sufficiently—say 10%, from $60,000 a year to $54,000—a $2,500 fee will still put you ahead.

Before retaining a broker, make sure the firm specializes in employee benefits. Get a listing of its clients to contact and samples of work done for other small businesses to appraise its track record. Find out whether the broker will act as an intermediary between your company and the insurance company once the plan is purchased. Check the broker's capabilities in handling claims and administrative procedures that can save you time and money.

Don't hesitate to change carriers to get a competitive rate, assuming the benefits are comparable. And keep tabs on the company's own financial health. If a carrier lost $100 million on its health insurance operation in the past year, for example, current policyholders such as you are going to absorb part of the loss through future premium increases.

3. Consider increasing deductibles. On many standard major medical plans, increasing an individual's deductible from $100 to $200 can save from 10% to 20% on premiums, while a $500 deductible can save 30% or more. The trade-off is whether your employees can afford or will accept the idea of absorbing more of the cost of their health benefits. That is a critical question but also a prime cost factor. It can be argued that if employees are responsible for more of the cost, they won't be frivolous about using the health-care system unnecessarily.

Although it may discriminate against unhealthy workers, one option is to offer rebates to employees who use little health insurance. Increase the deductible, setting aside the difference in a reserve fund. Any employee who spends less than the deductible amount within a given year or years gets the difference when he or she resigns or retires. Alternatively, the savings could be passed along through a direct cash payment or as a fringe benefit.

Another approach is to raise the shared portion for employees from a standard 20% of the first $2,000 of expenses to 20% of the first $5,000. That can save from 5% to 10% on premium costs. Since few employees spend $5,000 on medical bills in any given year, the added risk is negligible.

4. Make a pact with a preferred provider. A new entry among alternative health-care plans, preferred provider organizations (PPOs) exist in 12 major cities from Minneapolis to Los Angeles. Dealing with a preferred provider simply means that you get a preferred rate, in exchange for agreeing to direct your employees to particular physicians and hospitals. Co-payments and deductibles are generally waived if employees stick to the health-care providers participating in the plan. If they select other doctors or hospitals, care is covered but there are co-payments and an annual deductible.

5. Link up with other employers. If you employ fewer than 50 people, consider forming or joining a small-employer pool for purchasing health-care coverage. It may help you get a good package at a competitive rate. The larger your group, the better your bargaining power. You can form a pool on either an industry or a geographic basis. Conventional carriers can also help you find other groups to join. But remember that a group's experience—good and bad—will affect your costs, especially on an experience-rated premium based on the group's previous claims. ☐

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Annual Compensation Survey

HOW MUCH MANAGERS REALLY MAKE

NO-LAYOFF POLICIES

Do they make dollars and sense?

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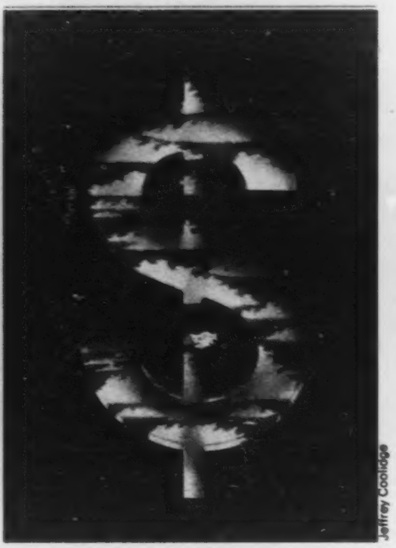
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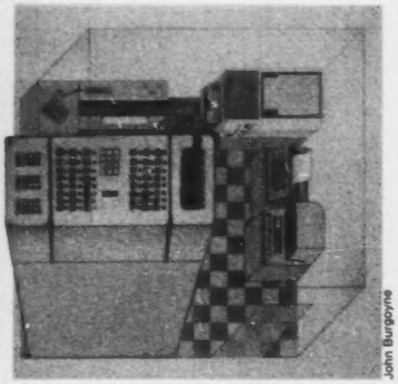
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Sculpture by Nicholas Fasciano; Painting by Bruce Sanders. Photo by Jeffrey Coolidge

How to balance the books.

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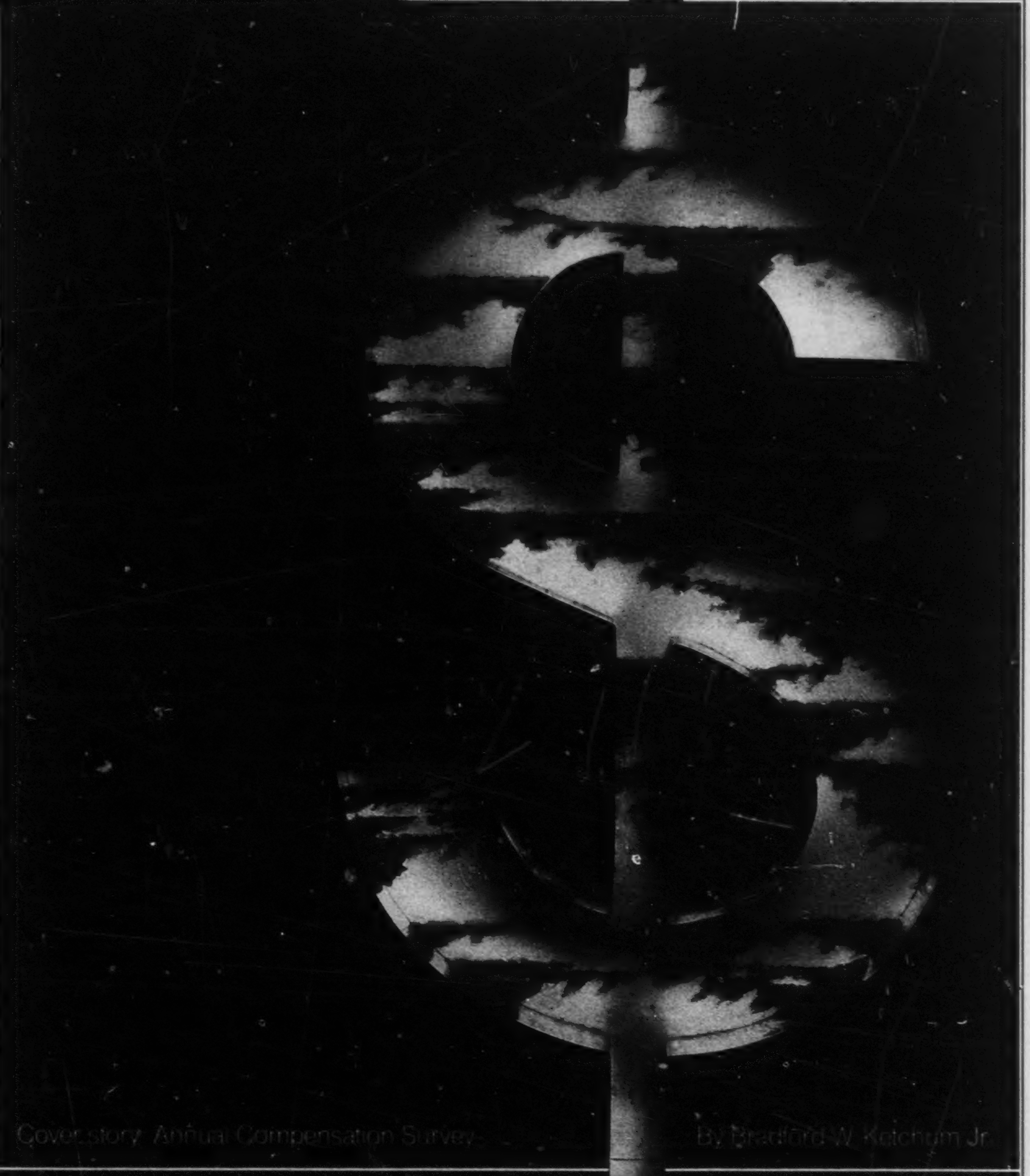

Cover story: Annual Compensation Survey

By Bradford W. Ketchum Jr.

WHAT MANAGERS MAKE

Insiders and outsiders alike have never been quite sure just what smaller-company middle managers are [illegible] what they make. While trade [illegible] directors [illegible] data on middle-management compensation in smaller companies is virtually nonexistent. With this special report, INC. seeks to fill that information gap.

Sculpture by Nicholas Fasciano; painting by Bruce Sanders; photo by Jeffrey Coolidge.

In most cases, the smaller company middle manager is a department head, supervisor, or other manager who reports to a top executive. Based on an INC. study of more than 7,000 smaller enterprises, the average middle manager is a male in his late thirties who joined his company about eight years ago and has held his position for almost five years. Besides his base salary of $25,200, he earns a bonus of $4,200 but reaps few benefits beyond basic health-care coverage. The brightest factor in his 1982 pay picture was a 10.8% increase in salary.

Modest is the word that best describes middle-management pay levels in smaller companies. Counting base salary and cash bonuses, most middle managers earn from $25,000 to $30,000. The average is $27,900. Add the value of other compensation, including discretionary benefits, and the average total compensation package for middle management amounts to $31,400.

These and other figures emerge from INC.'s Second Annual Compensation Survey of more than 7,000 smaller businesses in the United States. The results, based on responses from more than 375 companies employing more than 925 middle managers, reveal the standards behind current management pay practices. The chief conclusions drawn from the INC. study are summarized in the tables on the following pages. They show that:

Bigger companies do not necessarily dole out fatter paychecks. While compensation for manufacturing and marketing positions generally relates directly to company size, bigger does not always mean better pay for managers in other functional areas. For example, general managers in companies with sales of only $500,000 earned more last year than their counterparts in companies with sales of $5 million. Accounting managers in companies with sales of less than $2.5 million made more than those in companies with sales of $10 million. And data-processing managers in companies with $1 million to $2.5 million in sales came out ahead of counterparts in many companies that are 10 times larger. In fact, they chalked up average total remuneration of $39,900, compared with $27,400 earned by data-processing managers in the largest companies.

Counting salary and cash bonus, most middle managers earn from $25,000 to $30,000.

A similar pattern emerges when figures are analyzed by size of work force. Total remuneration for accounting managers in companies with 50 to 99 employees averaged $24,400 in 1981, compared with $23,500 earned by those in companies with 100 to 299 employees. Total compensation for data-processing managers in the smallest companies (1 to 49 employees) averaged $32,600, compared with $29,200 for data-processing managers in the largest companies (300 or more employees).

Pay scales are tipped by industry and function. Overall, there are few differences in industry pay levels. Across all industries, the average total remuneration for all middle managers ranged from $25,600 in the wholesale/retail trade to $29,700 in manufacturing companies. When management pay is also measured in terms of function, however, some businesses emerge as consistently more generous than others.

Middle managers in the construction industry are the highest paid smaller company managers, chalking up average total pay of more than $30,000 in two out of three positions covered by the INC. survey. Manufacturers and service businesses rank second, with one out of three management jobs topping $30,000. At the bottom of the pay scale are wholesale/retail businesses, which generally bless only finance and sales managers with pay levels of $30,000 or more.

Interestingly, a comparison of the highest-paid and lowest-paid positions by industry and function shows that branch managers in construction earn top honors (average total remuneration: $38,800), followed by data-processing managers in the service businesses ($37,600), and chief engineers in manufacturing concerns ($36,000). Lowest paychecks overall are earned by office managers in the construction industry ($14,300), personnel managers in service companies ($16,800), and accounting supervisors in manufacturing ($17,500).

Cash constitutes the biggest chunk of the pay package. Salaries and cash

WHAT'S A MIDDLE MANAGER?

In most smaller companies, middle management is the only line of management between executives and all other employees. The positions covered in this report therefore include department heads, supervisors, foremen, and other managers who report to a top officer (vice-president or above) and who are generally responsible for one or more subordinates.

While some middle managers have several responsibilities, their titles reflect their chief, if not sole, function. Companies responding to this study provided information on 927 middle managers with 251 titles. The titles were used to identify six major functional groups and 13 sub-groups. Compensation data for each position was tabulated by group. Typical middle-management positions within each group include the following:

Major groups

GENERAL MANAGEMENT: General, division, department, assistant manager; supervisor; foreman.

FINANCE: Controller; accounting, credit, finance, audit, business manager.

OPERATIONS: Operations, office, store, branch, data processing, personnel, warehouse, plant, land manager.

MANUFACTURING: Engineering, plant, maintenance, purchasing, production manager; R&D director.

MARKETING: Marketing, sales, merchandise, advertising, public relations manager.

OTHER: Service, parts, body-shop manager.

Sub-groups (positions included)

Controller
Accounting manager
Data-processing manager
Personnel manager
Service manager (national service, customer relations manager)
Store/branch manager (station manager)
Warehouse manager (distribution, transportation, fleet manager)
Office manager
Engineering/R&D manager (chief engineer; technical director; development, design manager)
Plant manager (plant foreman)
Purchasing manager (purchasing director, agent; material manager)
Production manager (shift, shop supervisor; quality assurance manager; shop, press foreman)
Sales manager (district, field, counter manager)

bonuses add up to more than 85% of the total compensation of smaller company managers. More than three out of four companies (79%) provide bonuses and, of those, 97% pay cash. (The remaining 3% offer stock bonus plans.) Last year, the average management bonus ranged from $3,200 for general managers to $6,600 for marketing managers, up from $2,500 and $5,800, respectively, in 1980.

While more than four out of five middle managers receive bonuses, business conditions apparently created a few minor shifts in bonus distribution last year. Fewer general and operations managers reaped bonuses, while finance managers saw their average bonuses shrink from $5,300 to $5,100.

Middle-management pay, like executive pay, is tied directly to performance and results in most cases. Two out of three smaller companies base their bonus payments on company profitability—the bottom-line results that directly reflect management performance. Another 30% also tie bonuses to department performance, while 15% cite company sales and individual effort as criteria. Only 5% award bonuses solely on the basis of executive discretion.

Fringes offer few frills. Health-care coverage is almost universal among management benefits. Beyond typical medical, life, and disability insurance, however, perquisite packages are highly conservative, if not limited. Profit-sharing programs and company cars are the most popular noninsurance perks, followed by pension plans. However, in each case, availability depends on company size. For example, among companies with sales of less than $5 million, only two out of five provide profit-sharing or company cars. Only one out of four offers pension benefits. In the $5 million-to-$10 million sales range, however, more than half the companies offer profit-sharing and company autos, and one out of three provides a pension plan.

The relative value of middle management's discretionary benefits, which generally represent about 12% of total compensation, is unlikely to increase. Insurance coverage, profit-sharing plans, and retirement benefits may be revised and expanded, but cash-related compensation will continue to serve as the primary motivator.

Two out of three companies boosted management pay for 1982. The average raise was 10.8%.

Business conditions create ripples in pay decisions. Overall, two out of three smaller companies boosted management compensation for 1982. By company size, the smallest businesses granted fewer—but more generous—raises. Average salary bumps ranged from 12.4% among businesses with sales of less than $1 million, to 9% among companies with sales of $5 million to $10 million. However, only 55% of the smaller companies awarded pay raises, versus 70% of the larger companies.

The number of companies that boosted middle-management salaries ranged from 52% of those in the construction business to 73% of the professional service companies. Most raises hovered around the 11% mark, ranging from an average of 9.5% meted by manufacturing companies to 12.9% in the professional services field.

Seventy percent of the respondents to the INC. survey indicated that they made no pay changes that were directly related to business conditions. However, among those who did react to the continued business crunch by modifying management compensation, the strategies went beyond simple salary pinches. Of the 103 companies that indicated shifts in pay policies due to sluggish economic conditions, 38% restricted raises, and 14% waived them altogether. Another 19% imposed management pay cuts, and 6% trimmed their benefits packages. A number cut back on the use of company cars and instituted tighter controls on expense accounts. Beyond these tactics, 1 out of 10 companies also instituted tougher performance standards, consolidated management responsibilities, or deferred hiring decisions.

Besides these insights on middle-management pay levels and practices, the INC. study also reveals several other characteristics of smaller company managers. Four principal points emerge from the survey results:

1. Few middle managers are oldtimers. In most cases, regardless of function, company size, or industry, the average age of middle management ranges

PROFILE OF MIDDLE MANAGERS (AVERAGE)

	General Management	Finance	Operations	Mfg.	Marketing	Other
1981 total remuneration	$27,200	$28,300	$25,100	$29,800	$32,000	$25,700
Base salary	25,000	24,900	22,800	27,000	28,000	24,200
Cash bonus	3,200	5,100	3,400	4,400	6,600	2,500
(% of mgrs. receiving)	87%	87%	81%	88%	91%	75%
Other compensation	2,700	4,100	3,700	3,500	4,000	2,100
(% of mgrs. receiving)	61%	67%	68%	76%	76%	54%
1980 total remuneration	$25,000	$26,300	$22,100	$27,200	$27,600	$23,000
Base salary	23,100	23,000	20,100	24,800	24,500	21,700
Cash bonus	2,500	5,300	2,800	3,900	5,800	2,400
(% of mgrs. receiving)	91%	82%	89%	86%	89%	70%
Other compensation	1,500	2,900	1,900	2,600	3,700	1,800
(% of mgrs. receiving)	58%	55%	59%	67%	75%	46%
Age	38	38	37	41	39	39
Years in position	4	5	4	6	4	5
Years with company	7	8	7	9	7	7
Ownership (% of respondents)						
None	91%	84%	88%	83%	84%	92%
Less than 5%	7	10	7	12	10	5
More than 5%	2	6	5	6	6	3

The average middle manager earns $25,000 to $32,000, including salary and bonus. While more than 8 out of 10 receive bonuses, salary generally accounts for about 90% of total pay The majority also receive other compensation, ranging in value from $2,100 to $4,100 and including deferred income and other discretionary benefits. Very few boast equity ownership in their company. Comparison of 1980–81 figures shows salary increases ranging from 8.2% for general management to 14.3% for marketing managers.

from 37 to 41. The oldest are those in manufacturing and marketing positions in companies with sales of $10 million or more, where about half of the managers fall in the 40-to-55 age bracket. Youngest are operations managers in companies with sales of $1 million to $5 million. More than three out of four of these managers are under 40. They include data-processing managers, four out of five of whom have yet to reach 40.

In terms of experience and seniority, most middle managers have been with their companies less than 10 years and have held their current positions an average of 5 years. Again, those in manufacturing functions tend to be far more seasoned than those in the operations areas. Not surprisingly, the experience of data-processing managers is testimony to recent recruiting and hiring activity among smaller companies. In short, indicating direct entry into the management ranks, the average data-processing manager has spent three years with the company in the same position.

2. Middle managers come in fours. And chances are, one of them is a woman (see box). Smaller company management ranks average 3 top executives and 4 middle managers. The depth of middle management is directly related to company size. Those companies with sales of less than $1 million, for example, employ an average of 2 middle managers. Companies in the $2.5 million-to-$5 million sales range average 5 middle managers; those in the $5 million-to-$10 million category average 7; and companies with sales of $10 million or more employ 11 middle managers.

The leanest management rosters are maintained by wholesale/retail businesses, which employ an average of four middle managers. Manufacturing companies and service businesses boast the highest number, with an average of seven.

3. Formal job descriptions are few and far between. Contributing to the lack of understanding about middle managers and their roles in smaller businesses is the fact that most companies—63%—have no formal job descriptions for middle management. In other words, in about two out of three cases, organizational structure has simply evolved and management responsibility remains loosely defined.

The lack of formal job descriptions appears unrelated to company size. Least likely to have a clear outline of manage-

PAYCHECKS BY STAFF SIZE: $20,000-PLUS BECOMES THE RULE

Average Total Remuneration ($ thousand)

	No. of company employees			
Function	**1-49**	**50-99**	**100-299**	**300 or more**
General management	$23.6	$25.1	$35.0	$51.2
Finance	25.7	31.2	30.3	32.9
Controller	28.3	32.8	32.4	32.3
Accounting	22.4	24.4	23.5	30.3
Operations	22.4	28.5	29.6	35.4
Data processing	32.6	27.3	28.6	29.2
Personnel	22.1	15.3	25.0	34.8
Service	24.3	23.5	41.3	45.1
Store/branch	23.4	23.7	36.0	40.1
Warehouse	17.8	20.3	25.8	27.6
Office	17.6	30.1	28.3	–
Manufacturing	25.8	29.7	33.1	41.8
Engineering/R&D	28.9	34.2	42.6	46.5
Plant	25.8	28.8	38.3	37.8
Purchasing	19.3	31.4	26.2	48.4
Production	25.7	26.7	27.8	38.4
Marketing	28.1	37.2	40.1	39.8
Sales	28.5	37.2	40.6	40.6

Most middle managers in companies with fewer than 100 employees earn less than $30,000. The exceptions are those who perform data processing, engineering, or sales functions. Those in companies with more than 100 employees generally fall in the $30,000-to-$40,000 pay range. On average, few middle-management positions, regardless of company staff size, top $40,000. Overall, 61% of the managers earn less than $30,000, 34% make from $30,000 to $49,999, and only 5% top $50,000.

MIDDLE-MANAGEMENT PAY BY INDUSTRY: CONTRACTORS LEAD, SERVICE COMPANIES TRAIL

Average Total Remuneration ($ thousand)

	Annual company sales					
Function	**Manufacturing**	**Wholesale/ Retail**	**Services/ Business**	**Services/ Profess.**	**Construction**	**Other**
General management	$29.9	$20.7	$32.1	$27.7	$33.1	$26.8
Finance	27.6	28.8	34.2	26.7	27.5	27.6
Controller	29.1	32.8	30.0	28.1	30.3	36.3
Accounting	17.5	21.4	36.2	23.9	21.8	20.7
Operations	26.1	24.2	25.6	26.2	23.0	25.2
Data processing	30.4	29.6	37.6	23.6	–	–
Personnel	31.6	24.0	16.8	22.0	–	25.4
Service	25.7	24.0	24.4	33.2	31.2	39.9
Store/branch	24.3	23.5	23.2	28.8	38.8	36.5
Warehouse	23.5	19.6	23.7	–	–	24.0
Office	21.2	20.7	18.0	21.5	14.3	20.3
Manufacturing	30.2	25.6	28.1	29.8	30.9	33.9
Engineering/R&D	36.0	–	–	30.9	34.0	40.3
Plant	30.8	22.4	24.7	–	33.4	32.7
Purchasing	28.8	27.5	–	–	29.2	–
Production	25.8	26.2	27.7	29.8	30.3	32.9
Marketing	35.2	31.0	31.4	28.9	36.0	26.7
Sales	35.2	31.3	31.4	28.4	36.0	28.5

The highest-paying jobs are in the construction industry, where two out of three middle managers make more than $30,000, on average. Other top-paying jobs include financial and data-processing positions in the service businesses. Lowest pay levels are found in the wholesale/retail industry, where remuneration ranges from $19,600 to $31,300, with an average of $25,600 for all middle managers.

ment responsibilities are companies with sales of less than $1 million. However, companies in the $1 million-to-$2.5 million sales range are better organized than those with sales of more than $10 million when it comes to formal job descriptions for middle management. The number of companies with written job definitions in these two groups is 51% and 46%, respectively.

By industry, the amount of businesses that have spelled out their middle management responsibilities ranges from 28% among wholesaler/retailers to 48% of the construction companies.

4. The accent is on middle-management development. More than 70% of the respondents to the INC. survey indicated that they encourage management training and development. In general, the primary emphasis is on education, ranging from outside seminars to correspondence courses and participation in trade associations. Not surprisingly, the larger the company, the more likely it is that management training will be emphasized.

Among respondents, 84% encourage their managers to attend outside seminars, 48% endorse college courses, and

HOW MANY WOMEN WIN MANAGER ROLES?

Women occupy middle-management slots in more than half of the smaller companies that responded to the INC. survey. While 47% of the respondents reported no women in their middle-manager ranks, 53% employ at least one woman manager.

Generally, service companies offer women more opportunities than manufacturing companies. Three out of five service businesses employ women in management, versus only two out of five manufacturers. Not surprisingly, company size is also a factor. The larger the company, the more likely it is that its management ranks include women.

Among the larger companies (sales of $5 million or more), 58% employ women in management roles. Of those, 38% have one woman manager, 4% have two, and 16% have three or more. Among the smallest companies (sales of less than $1 million), the ratio is far less favorable to women. The majority (55%) have no women in middle management. Of the remaining companies, 35% report only one woman with management responsibilities.

No attempt was made to compare the compensation levels of men and women. But women are best represented in the office management functions, which, the survey shows, are the lowest paying (average remuneration: $19,700). However, women have also landed some of the highest-paying management jobs, which include sales and marketing positions (average pay: $32,000).

Women win fewest roles in the manufacturing and service functions, which include engineering and maintenance.

Number of women	**Percent of respondents**
None	47%
One	34
Two	10
Three	5
Four or more	4
Average no.: 1	

Function	
Office	39%
Finance	24
Sales	19
Marketing	12
Gen. management	9
Personnel	9
Operations	9
Accounting	9
Data processing	6
Production	5
Warehouse	5
Store/branch	5
Purchasing	3
Manufacturing	2
Service	1

Total exceeds 100% because of multiple responses.

PAYCHECKS BY SALES SIZE: ENGINEERS EARN TOP DOLLAR

Average Total Remuneration ($ thousand)

		Annual company sales					
Function	**All respon.**	**Up to $500,000**	**$500,000-$999,999**	**$1 mil.-$2.4 mil.**	**$2.5 mil.-$4.9 mil.**	**$5 mil.-$9.9 mil.**	**$10 mil. or more**
General management	$27.2	$19.4	$23.6	$27.2	$27.5	$23.2	$34.2
Finance	28.3	22.5	22.1	28.2	31.0	27.7	31.5
Controller	30.7	25.0	24.0	29.5	31.6	29.4	34.1
Accounting	24.1	21.0	22.0	24.7	15.8	25.8	20.2
Operations	25.1	21.0	24.7	22.3	23.0	24.6	36.5
Data processing	30.7	25.5	–	39.9	36.3	23.6	27.4
Personnel	26.9	–	22.0	15.3	14.0	25.5	32.9
Service	26.7	22.5	20.4	23.7	24.6	26.1	38.7
Store/branch	26.3	14.5	26.6	22.4	21.0	31.1	46.9
Warehouse	21.0	17.9	–	20.2	18.4	20.0	27.2
Office	19.7	19.8	16.4	16.7	18.8	20.8	35.1
Manufacturing	29.8	21.2	20.9	28.5	30.3	30.2	37.6
Engineering/R&D	35.0	25.2	20.7	33.8	34.8	40.2	43.7
Plant	29.4	23.2	21.8	27.1	26.5	32.2	39.9
Purchasing	28.5	14.0	–	20.1	34.0	25.7	31.3
Production	27.9	19.6	20.5	30.8	28.9	27.2	33.3
Marketing	32.0	24.5	16.9	29.9	32.4	34.2	44.3
Sales	32.4	24.5	17.0	30.7	33.1	34.2	45.5

Middle-management paychecks do not necessarily keep pace with company size, particularly for general management, accounting, and data-processing positions. Generally, however, the highest-paying jobs are in engineering/research and development, followed by sales and marketing. Lowest on the payroll totem pole are office and warehouse managers.

40% sponsor membership in professional organizations or societies that offer training programs. Other efforts include in-house training (11%), active trade group participation (5%), and correspondence courses (3%).

In summarizing the problems of dealing with middle management, respondents cited training as a major hurdle—second only to motivation. Indicative of their intent to solve the problem, 84% report that their companies reimburse middle managers for job-related educational expenses. □

Bradford W. Ketchum Jr. is a senior editor at INC.; *assistance was provided by Richard A. Powers,* INC. *research director.*

BEYOND PAYCHECKS: PERKS AT WHAT COST?

Benefit	% of respondents offering benefit	% of benefit paid by the company 100	50-99	1-49
Hospital/medical insurance	97	75[1]	22	3
Life insurance	82	87	11	2
Disability Insurance	55	83	14	3
Profit-sharing	43	95	3	2
Company car	42	88	9	3
Pension	31	79	14	7
Dental insurance	28	79	19	2
Club membership	13	82	15	3
Low-interest loans	10	–	–	–
Stock ownership (ESOP)	8	–	–	–

[1] % of the companies providing benefit

Function	Average value of deferred income, options, other discretionary benefits 1981	1980
General management	$2,700	$1,500
Finance	4,100	2,900
Operations	3,700	1,900
Manufacturing	3,500	2,600
Marketing	4,000	3,700
Other	2,100	1,800

Most middle managers are covered by medical, life, and disability insurance. Beyond these common benefits, profit-sharing and company cars are provided by two out of five companies. Dental coverage, club privileges, and employee stock ownership are far more the exception than the rule. Where benefits are offered, 100% of the cost is underwritten by at least three out of four employers. The average value of compensation beyond base salary and bonus ranges from $2,100 to $4,100.

THE FACTS BEHIND THE FIGURES

This report represents INC.'s Second Annual Compensation Survey. It summarizes a national study of middle management compensation levels and policies in a broad cross-section of smaller businesses. The primary research for the report was conducted in June. A four-page questionnaire was mailed to a random sampling of 7,024 INC. subscribers. Excluding undeliverable, incomplete, and late returns (those received beyond a June 10 deadline), the net response rate was 5.4%. Some 377 usable returns were then delivered to an independent computer facility for tabulation and cross-reference summaries.

Confidentiality of all information was assured. No company or individual respondent was identified. The responses represent 377 companies that provided compensation data on a total of 927 middle managers. In 76% of the cases, the information was submitted by a top officer, including chairman, president, or owner/partner.

Located in 40 states and the District of Columbia, the respondents also represent 78 four-digit Standard Industrial Classifications within 11 broad industry categories. The majority are in manufacturing (27%) or wholesale/retail business (27%). Other major groups include service/business (16%), service/professional (13%), and construction (8%). Ninety-two percent are corporations, 5% partnerships, and 3% proprietorships. Only 6% are publicly held.

The vital statistics of the respondents as a group include the following averages:

Net sales	$3,902,000
Net income (after taxes)	$162,500
Number of employees	74
Total 1981 payroll	$971,000
Number of top executives	3
Number of middle managers	4
Total remuneration	$27,900
Base salary	$25,200
Cash bonus	$4,200

HOW BIG ARE BONUSES?

Cash bonus	No. of company employees 1-49	50-99	100-299
None	15%[1]	12%	18%
$1,000–$4,999	57	64	56
$5,000–$9,999	15	10	14
$10,000–$19,999	10	10	7
$20,000 or more	3	4	5

[1] % of the middle managers, 1981

SALARY INCREASES FOR '82

1982	Percent of respondents
Increased salaries	64%
Did not increase salaries	36%

Industry	Average increase	Size of raise 1-9%	10-14%	15%+
Mfg.	9.5%	54[1]	39	7
Whsle./retail	10.6	33	50	17
Service/business	11.0	46	38	16
Service/profess.	12.9	30	37	33
Construc.	12.2	23	54	23
All respon.	10.8	42	41	17

[1] % of the companies giving raise

Two out of three companies increased middle-management salaries this year. Among those who granted raises, 42% kept the increases below 10%, and 41% awarded increases of 10% to 15%. The average raise was 10.8%.

THE 10 BIGGEST PROBLEMS WITH MIDDLE MANAGERS

Problem	Percent of respondents
1. Motivation, defining roles and goals	38%
2. Training	24
3. Recruitment	17
4. Turnover	9
5. Skills with subordinates	6
6. Communication with top management	5
7. Quality adherence and accountability	4
8. Creativity, generating innovative ideas	4
9. Too many the same age	2
10. Room for advancement	1

(Total exceeds 100% because of multiple responses.)

More than one out of three companies cite motivation as the chief hurdle in dealing with middle managers. Other problems range from training and recruitment to creating opportunity for advancement.

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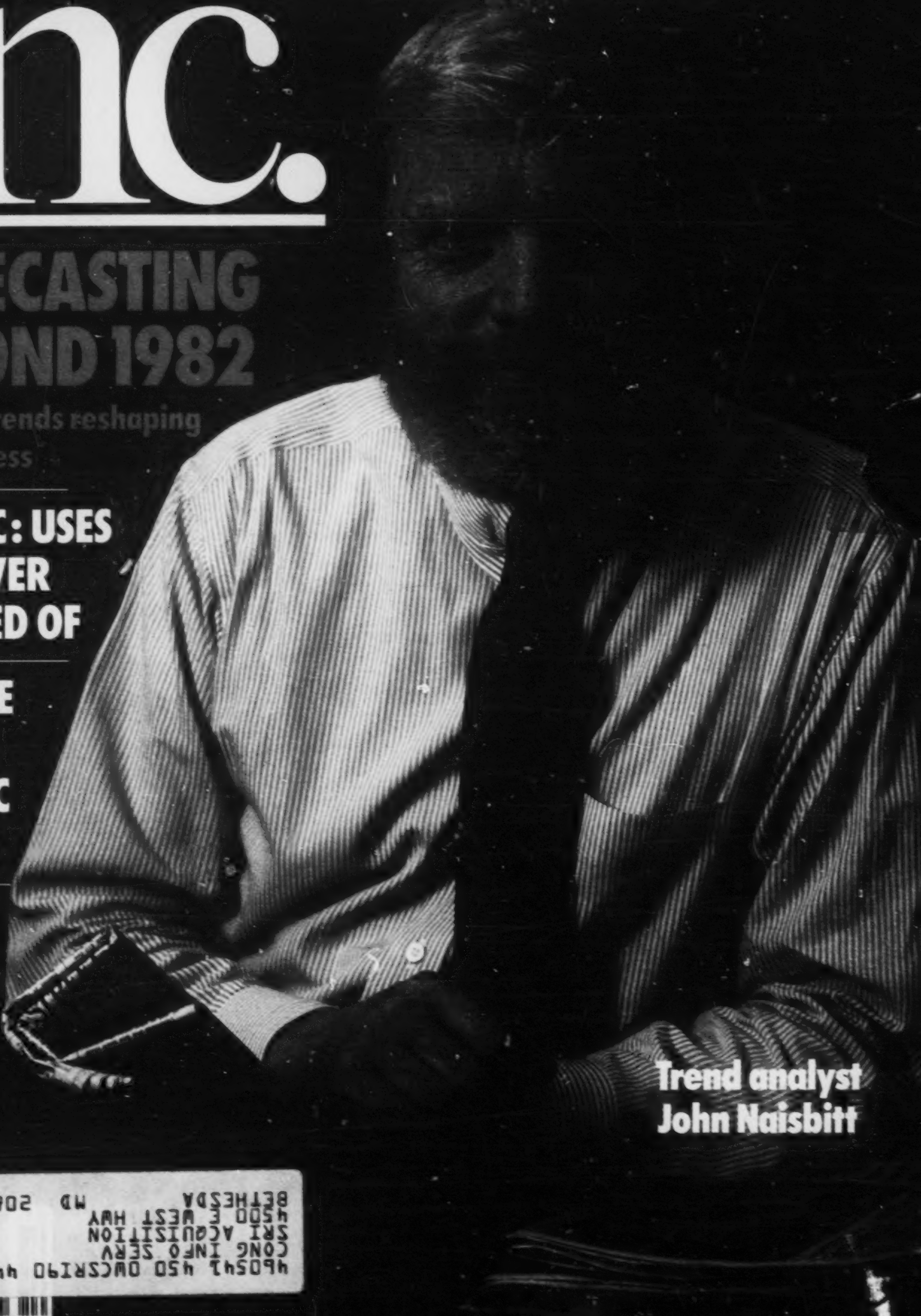
Rating business climates



Trend analyst John Naisbitt

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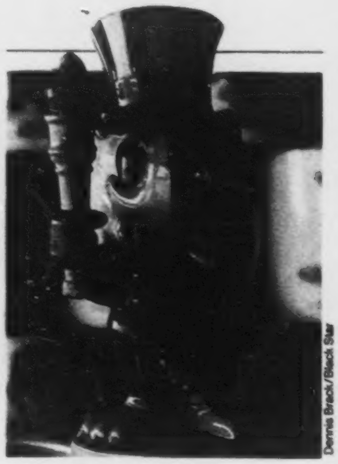
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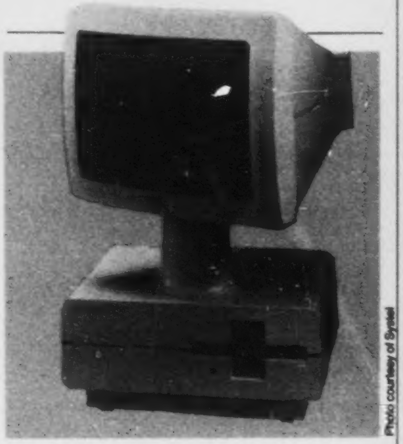

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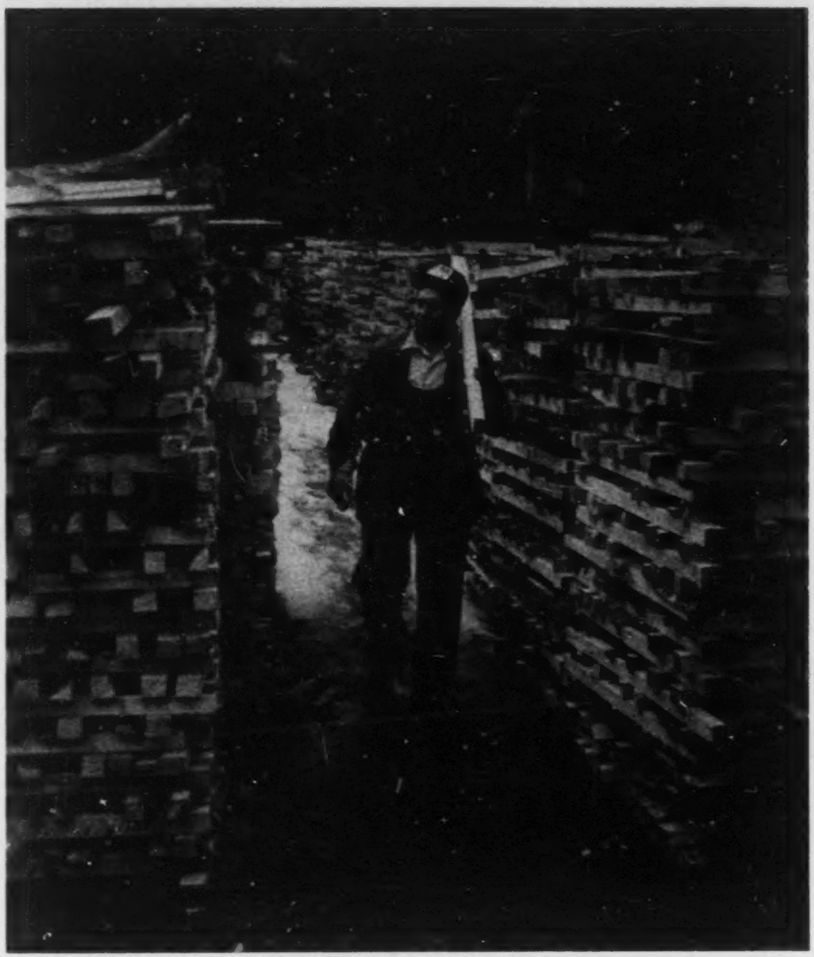

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A REPORT ON THE STATES

INC.'s second annual study rates 50 small business climates.

By Bruce G. Posner

If your company's history is anything like that of most small companies, where it is located—be it Palo Alto, Calif., or Portland, Maine—has nothing to do with any carefully drawn corporate plan Instead, you put the business where you were raised, attended school, or simply wanted to live. Presumably, the area had much of what you wanted of the myriad things that influence "quality of life." Perhaps there was good skiing, music, or a major university within easy reach. Or you may have wanted to be near people in similar vocations, which may be why so many high-technology companies grew or are expanding in California's Silicon Valley and along Boston's Route 128.

Although state officials everywhere wish they could do more to spawn and keep growth-oriented companies, all too often they find that it is hard enough to define the amenities that attract small businesspeople without trying to influence a decision to set up business. But apart from the intangibles in appraising a business climate, there are factors that are both more concrete and, to some extent, within a state's control.

As companies grow, for example, they may need long-term debt and equity, in addition to working capital. They may also need to hire employees who have specialized skills. A company's inability to find such fundamental resources when they are needed can greatly influence its success, and it can also dampen the growth of the economy within the state.

The purpose of INC.'s second report on the states is to compare some of the major, quantifiable aspects of the climate for small business, to help businesspeople and state officials understand better how to make improvements. In selecting the criteria for measuring the 50 states as homes for smaller companies, INC. interviewed economists, state development officials, venture capitalists, and small business executives. INC. also talked with special liaison people appointed by governors to gather information on small business support programs in every state.

The analysis focused on areas of broad concern to all small companies, rather than such factors as transportation and energy, important as these may be to some businesses. Since all small business operators have capital and labor needs and are affected by taxes, we looked at the impact of those three factors on small companies. Growth opportunities in a particular environment are also influenced—sometimes heavily—by external economic and business factors. These factors, therefore, are reflected through a number of criteria under the heading of business activity.

Finally, we examined each state for small business support programs initiated at the executive or legislative level. The mere existence of official support does not

Illustrations by Michael Blaser

RATING THE STATES BASED ON FIVE MAJOR FACTORS

	CAPITAL RESOURCES				LABOR				TAXES
Rank/state	**Bank loans % assets**	**Comm./ind loans per capita**	**SBIC finan. per 1,000 pop.**	**State programs[1]**	**Avg. wkly. wage**	**% union**	**% H.S. grads.**	**Value added per worker (thou./yr.)**	**Per $1,000 personal income**
Median	53.5%	$ 927	$0.8	–	$317	23%	68%	$43.6	$112
1. Texas	54.8%	$2,527	$3.9	DL	$328	11%	65%	$55.1	$ 98
2. California	64.7	1,468	3.2	DL,LG	339	27	74	48.0	122
3. Colorado	57.9	1,262	3.1	–	326	18	78	45.7	113
4. Florida	49.5	598	1.2	–	265	12	65	37.0	97
5. New Hampshire	63.2	588	1.8	LG	256	16	70	31.2	92
6. Kansas	48.4	1,082	1.4	–	325	15	73	44.0	100
7. Arizona	62.6	888	0.6	–	317	16	73	47.7	133
8. Oregon	58.8	1,112	1.8	DL	352	26	76	39.0	114
9. Oklahoma	52.8	1,921	1.2	DL	329	15	66	42.2	102
10. Washington	58.9	1,382	0.9	–	405	34	76	49.5	109
11. New Mexico	52.7	1,043	2.3	–	259	19	66	36.0	122
12. New York	54.4	4,164	2.2	DL,LG,BG	309	39	66	47.2	163
13. Kentucky	49.2	773	1.0	DL,BG	309	24	53	45.6	104
14. North Dakota	50.1	1,245	–	BG	271	17	68	52.6	102
15. Connecticut	59.7	857	5.1	DL,LG,VC	319	23	70	42.8	105
16. Virginia	60.0	718	0.9	–	270	15	64	36.0	102
17. Nevada	59.5	738	0.3	LG	325	24	76	51.0	105
18. Massachusetts	50.0	1,213	2.1	DL,BG,VC	280	25	72	40.0	139
19. Minnesota	54.5	1,430	2.7	DL	331	26	73	45.5	127
20. New Jersey	53.1	765	0.9	DL,LG,BG	322	26	66	47.4	117
21. Utah	56.5	838	0.1	–	308	18	80	40.4	125
22. Arkansas	52.1	946	0.2	BG	247	16	56	30.4	99
23. Georgia	52.8	683	1.0	–	255	15	59	33.3	108
24. Tennessee	51.9	908	0.5	–	268	19	55	33.7	94
25. Wyoming	53.4	1,541	2.6	–	314	19	76	61.4	148
26. Mississippi	50.6	639	0.8	LG	236	16	52	31.6	109
27. Montana	55.1	1,176	1.2	–	370	29	73	47.9	130
28. Maryland	57.1	555	0.3	DL,LG,BG	335	23*	69	43.7	120
29. Missouri	47.4	1,112	0.1	BG	318	28	64	43.6	93
30. Ohio	50.4	757	0.6	DL,LG	390	31	68	46.6	94
31. Rhode Island	55.0	1,426	0.4	DL,LG,BG	240	28	62	28.4	119
32. Idaho	55.8	944	3.5	–	311	18	72	36.0	104
33. Illinois	58.7	2,841	0.7	DL	356	30	66	47.0	112
34. North Carolina	51.4	804	0.5	–	232	10	55	30.6	106
35. Wisconsin	55.8	853	0.6	DL	353	29	70	43.6	125
36. Michigan	54.3	909	0.7	DL	426	37	69	47.6	115
37. Pennsylvania	53.5	1,365	0.5	DL	325	35	65	38.5	116
38. Vermont	66.3	712	1.3	DL,LG	272	18	70	36.6	127
39. Hawaii	60.6	992	0.1	DL	290	28	73	45.1	148
40. Iowa	48.6	854	0.1	DL	379	22	72	51.0	111
41. South Dakota	67.5	1,039	1.5	–	296	15	69	36.6	106
42. Indiana	51.4	726	0.3	DL,LG,VC	376	30	67	43.5	88
43. Nebraska	50.6	965	0.2	–	324	18	74	46.7	111
44. Louisiana	52.2	1,231	1.6	DL,LG	362	16	58	64.9	116
45. Alaska	45.0	978	0.2	DL,BG,VC	457	34	80	54.2	368
46. Alabama	48.7	664	0.7	–	280	22	56	30.8	96
47. South Carolina	48.2	361	0.6	–	250	8	57	27.3	107
48. Maine	54.1	502	0.5	DL,LG	296	24	68	27.8	125
49. Delaware	46.3	551	–	–	333	25	70	49.4	116
50. West Virginia	49.8	499	0.1	DL,LG	347	34	53	43.5	112

[1] DL-direct loans, LG-loan guarantees, BG-bond guarantees, VC-venture capital

[2] AO-advisory office, OM-ombudsman, AC-advisory council, LC-legislative committee, SC-statewide conference, PS-procurement set-asides

* Includes union membership in District of Columbia.

STATE SUPPORT	BUSINESS ACTIVITY				
Small bus. assistance[1] (1971-80)	Pop. % change (1971-80)	Employmt. % gain (1971-80)	Pers. inc. % change (1971-80)	Business units per 1,000 pop.	INC.100 companies (1979-82)
–	11.5%	27.7%	45.4%	46	2
AO,OM,AC,LC,SC	27.1	67.8	77.4	47	27
AO,OM,AC,LC,SC	18.5	41.6	48.7	46	49
AO,OM,AC,SC	30.7	61.0	74.2	50	13
AO,OM,LC,SC,PS	43.4	65.9	77.1	55	10
AO,LC,SC,PS	24.6	47.9	56.7	46	2
AO,AC,LC,SC,PS	5.3	63.2	43.5	46	1
AO,OM,AC,SC,PS	53.3	79.7	88.7	49	3
AO,OM,AC,SC	26.5	46.5	64.3	51	4
AO,SC,PS	17.2	46.6	65.6	49	6
AO,LC,SC,PS	21.0	25.1	60.4	47	4
AO,OM,SC,PS	24.7	58.0	67.6	50	2
AO,OM,AC,LC,SC,PS	-3.3	0.6	9.1	46	31
AO,OM,AC,LC,SC,PS	13.7	41.8	44.4	40	1
AO,AC,LC,SC	5.6	50.5	45.5	54	–
AO,OM,PS	2.5	17.0	26.7	43	6
AO,OM,SC	11.8	39.6	50.3	39	5
AO,LC,SC	63.8	96.8	92.0	50	1
AO,OM,LC,SC	0.8	17.1	21.3	40	12
AO,OM,LC,SC	6.9	34.6	37.9	41	18
AO,OM,AC,LC,SC	2.7	17.2	22.2	44	16
AO,OM,AC,SC	37.9	32.6	70.3	48	1
AO,AC,SC,PS	18.5	38.9	60.3	45	0
AO,OM,AC,LC	17.8	37.8	49.7	45	6
AO,OM,AC,SC,PS	13.0	13.3	50.0	42	4
–	41.1	88.6	123.1	57	4
AO,OM,AC,LC,SC	12.9	34.4	50.0	44	1
AO,AC,SC,PS	13.3	42.4	42.3	56	–
AO,AC,LC,SC,PS	7.5	25.6	34.2	35	5
AO,OM,LC,SC,PS	5.1	18.5	31.9	44	1
AO,OM,AC,LC,SC	1.0	13.3	24.9	40	3
AO,AC,LC,SC,PS	-0.4	15.8	25.0	47	–
–	32.3	58.7	61.5	50	–
AO,OM,AC,LC,SC,PS	1.2	14.5	23.9	41	–
AO,AC,LC,SC	15.5	33.8	45.2	41	1
AO,OM,AC,LC,SC	6.5	27.1	36.5	40	3
AO,OM,AC,SC,PS	4.2	15.0	32.6	37	2
AO,OM,AC,SC,PS	0.2	8.6	24.9	42	6
AO,SC	15.0	35.1	29.4	54	–
AC,LC,SC	25.3	37.5	41.0	52	2
OM,AC,LC,PS	3.1	24.7	31.9	47	1
AC	3.8	36.0	30.4	50	–
OM,SC,PS	5.7	17.4	31.0	39	6
AO,OM,SC	5.3	30.7	34.4	49	–
AO	15.3	51.8	65.8	46	1
OM,SC	32.5	84.3	93.3	49	1
OM,SC,PS	12.9	34.4	50.9	41	2
AO,SC,PS	10.8	41.0	53.0	42	3
AO,OM,AC	13.2	26.3	38.9	49	–
AO,OM,AC,LC,PS	8.6	21.3	29.6	44	–
AO,OM,LC,SC,PS	11.8	25.1	49.1	43	–

Sources (by column, left to right): Federal Deposit Insurance Corp. (1,2); U.S. Small Business Administration (3); State development agencies (4); U. S. Department of Labor, Bureau of Labor Statistics (5,6); U.S. Department of Education (7); Bureau of Census, Census of Manufacturers (8); Tax Foundation (9); INC. survey of 50 states (10); Bureau of the Census (11); Bureau of Labor Statistics (12); U.S. Department of Commerce, Bureau of Economic Analysis (13); Bureau of the Census, County Business Patterns (14); INC. (15).

guarantee that significant numbers of small companies are being helped. However, support for innovative programs and a strong commitment to small business at high levels can be enormously useful. Through special programs, a state can leverage its existing capital and labor resources to the benefit of small businesses. State support can also soften the effects of a declining economy.

INC. ranked the 50 states in five categories. Each category—capital, labor, taxes, business activity, and state support—was weighted to reflect its relative importance to small companies. The scoring system was based on a scale of 100 points. Because most of the experts we spoke with considered capital resources and state support the two most critical factors, each was given 25 points. Taxes, while always an area of real concern, received only 10 points, the lowest weighting, since taxes rarely play more than a minor role in the investment decisions of small companies. Labor and business activity were each weighted at 20 points to reflect their broad significance to smaller companies. Calculated by this method, the overall scores range from 82 for Texas to 33 for West Virginia.

Texas achieved the top overall ranking with an unbeatable combination of strong capital resources, an effective labor force, and a low tax burden. But it was further aided by a high level of business activity within the state and official support for small business. California and Colorado, with higher tax rates than Texas, placed second and third, respectively, largely because of their strength in capital and labor. Each also received a very helpful boost from a robust economy.

Fourth-ranking Florida scored very favorably in labor, taxes, business activity, and small business support, but appeared in the bottom 10 for capital resources. For the other states scoring low in capital, such as West Virginia and Delaware, the impact on the overall ranking was often devastating. They did not compensate as well as Florida did with strengths in other areas.

West Virginia, for example, ranked 50th overall and scored weakly on labor and business activity and only average in taxes and small business support. Its ranking of 49th in capital resources—low lending activity compared with bank assets—compounds its weakness in other areas. Delaware, although somewhat stronger than West Virginia in labor and business activity, also suffers from its poor showing in capital. It ranks last in the capital category and 49th overall. In fact, four of the five lowest-ranking states on the summary table (West Virginia, Delaware, South Carolina, and Alabama) are the weakest four states for capital resources. The fifth state, Maine, ranks 48th overall and also suffers in terms of capital.

The influence of other categories, while important, proved less decisive in a state's ranking. Although 7 of the top 10 states had very favorable climates for labor—only Oregon, Oklahoma, and Washington did not—poor performers in labor (reflecting such factors as high levels of wages, low level of education, and the strong presence of organized labor) did not automatically suffer in the overall rankings. In fact, only three states scoring low in labor—Indiana, West Virginia, and Alabama—appeared in the bottom 10 overall. Other high-wage and highly unionized states, such as Ohio, Illinois, Michigan, and Pennsylvania, ranked higher because of stronger showings in other areas.

At first glance, Indiana's rank of 42 seems surprisingly weak in relation to such midwestern neighbors as Illinois and Michigan. While none of these states ranks very favorably in terms of labor or business activity—measures by which Illinois ranks at the very bottom—Indiana distinguishes itself by having the lowest taxes (per $1,000 of personal income) in the nation, while Illinois and Michigan fall in the middle.

Nevertheless, Indiana parts company from Illinois and Michigan in small business support activities. Unlike Michigan, for example, Indiana has neither a small business assistance office nor a governor's advisory council on small business. It also lacks a legislative committee devoted to small business matters, as Illinois and 11 other states have had and as 9 states have now added. To Indiana's credit, though, its officials have recently shown an interest in bolstering small business capital resources through the state's new Corporation for Innovation Development (see page 100).

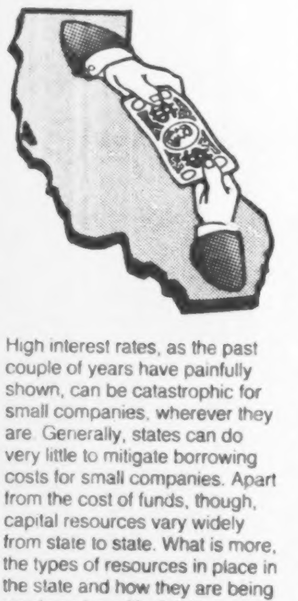
A careful examination of the accompanying table shows that even states that appear quite similar can differ dramatically. But the most useful discovery may be that each of the 50 states has its own set of strengths. The Midwest and the New England states, for instance, are clearly not seeing the same heady growth as Texas and California. But both regions can become vibrant areas for small companies.

Increasingly, states concerned about the future are examining their support programs as the most obvious way of upgrading their climate for small business. Delaware, for example, made notable strides in the past year when it created four support vehicles—an advisory council, a legislative committee, an assistance office, and a program requiring the state to purchase goods and services from small companies.

THE BEST OF SHOW

Capital: Activity at the money centers

1. California
2. Connecticut
3. New York
4. Texas
5. Massachusetts
6. Minnesota
7. Colorado
8. Illinois
9. Oklahoma
10. Wyoming



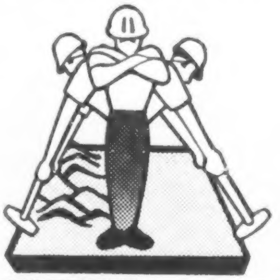
High interest rates, as the past couple of years have painfully shown, can be catastrophic for small companies, wherever they are. Generally, states can do very little to mitigate borrowing costs for small companies. Apart from the cost of funds, though, capital resources vary widely from state to state. What is more, the types of resources in place in the state and how they are being used can be critical if, like most companies, yours cannot meet all its capital needs. Therefore, capital resources, along with state support programs, receive our heaviest overall consideration in ranking the states' climate for small business.

To see how the states stack up in terms of capital resources for small business, INC. looked first at two sets of banking industry figures—total state commercial bank loans as a percentage of total assets, and commercial and industrial bank loans on a per capita basis. While these measures don't tell what types of businesses are getting the loans—or even whether all the funds are being lent within the state—they usually reflect the degree to which banks are using their asset bases for aggressive lending to meet the working capital needs of business.

INC. also analyzed the states for special capital programs, such as direct loans, loan guarantees, bond guarantees, and state-sponsored venture capital investing, in the belief that these can help bring capital other than working capital to small companies. Because most experts believe that even small-issue industrial revenue bonds tend to benefit large companies and their subsidiaries with solid credit histories, we didn't consider IRBs. Finally, INC. looked at small business investment company (SBIC) investments in the states on a per capita basis, as an indicator of the relative availability of venture capital.

California, with its aggressive banks and active SBICs, emerges as the state with the most extensive capital resources for small business, a distinction it certainly would have earned more easily had all sources of private venture capital been included. Next come Connecticut and New York, whose ranks reflect their active banks, SBICs, and the targeted capital programs in place. Oklahoma and Wyoming aren't usually thought of as states with substantial capital resources, but both benefit from high levels of SBIC investments and per capita commercial and industrial bank loans.

South Carolina, West Virginia, and Delaware emerge as the states where a lack of capital resources—or an unwillingness on the part of commercial banks to lend—poses hurdles for growing small businesses. For instance, commercial and industrial lending in these three states is anemic compared to that in the rest of the states. Low levels of banking activity within a state can, of course, stem from depressed loan demand in a slow economy, but conservative bankers seem to be at least as great a factor.



Labor: The Plains states set the pace

1. Wyoming
2. North Dakota
3. Nevada
4. Kansas
5. Nebraska
6. Arizona
7. Colorado
8. New Hampshire
9. Utah
10. South Dakota

When it comes to labor, the needs of different types of small businesses vary substantially. Most companies, of course, are interested in keeping labor costs down as much as possible. But few can afford to ignore requirements involving skill and concerns over productivity.

In examining labor markets within each state, INC. looked at comparative wage levels for manufacturing and at comparative levels of unionization, which can be a factor in high wages. But in addition to factors affecting the price of labor, INC. also compared the states by levels of productivity and by levels of education among workers.

For productivity, the question was how much each worker added to the value of manufactured goods. In education, the percentage of state residents over the age of 18 who have completed high school was considered, although companies needing highly skilled employees might consider the number of engineering graduates.

At the top of the chart for labor are Wyoming, North Dakota, Nevada, Kansas, and Nebraska. Among these high scorers, however, Kansas is the only state with low union activity. None of the 5 states ranks among the top 10 in terms of low wages. In all but North Dakota, however, 73% or more of their residents over the age of 18 hold high school degrees.

Poorest performers in the labor category are West Virginia, Illinois, Indiana, and Pennsylvania. They have work forces in which only 53% to 67% of the workers hold high school de-

Such programs can be extremely valuable for bringing awareness and help to small companies. But for states facing difficult economic times and declining industries, the future may require more specialized programs in the areas of capital resources, job training, and technical assistance—all aimed at broadening opportunities for small businesses.

In the past, several states targeted most of their initiatives at existing companies, through efforts such as technical assistance programs in conjunction with universities. But increasingly, some states—Pennsylvania, Georgia, and New York, for example—appear to be highlighting new companies as the important thrust in their economic development efforts. Each of these states is directing money into supporting technology-based start-ups, with technical universities playing key roles (see page 100). Notes Roger Vaughan, a consultant at the Council of State Planning Agencies in Washington, D.C., and former deputy planning director of New York: "States interested in distinguishing themselves will have to do a lot more in helping new businesses come about."

Just as important to the small business climates of many states, though, may be how well the capital and labor needs of growing companies can be met. A growing number of states are considering such measures as the revamping of investment guidelines on public employee pension funds and increasing the outlays for technical education. Through its new Technology Park Corp., for instance, Massachusetts is putting up $20 million for a center co-funded by industry in order to train engineers and other technical specialists in microelectronics.

Some experts are convinced that every state will need to help reshape its work force to accommodate businesses. During the next decade companies are going to need a great many technically competent workers for seemingly nontechnical jobs, according to a number of authorities on small business.

It may not be easy for public officials to think about helping small business in such ways, especially in the Midwest and the South, where the emphasis has long been on big companies and large manufacturing plants. "Politicians don't have to learn how to wave 1,000 jobs around," says Alexander Dingee, president of Venture Founders Corp., a Waltham, Mass., company specializing in assistance to start-up companies. "But it's a lot harder for them to make election-year claims about how they've helped small companies." ☐

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grees, and all are heavily unionized in their major industries. In addition, wages for Illinois and Indiana workers average among the highest for manufacturing in the nation.

State support: Kentucky leads the bandwagon

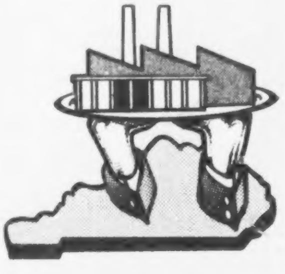
1. Kentucky
2. New York
3. Illinois
4. California
5. Wisconsin
6. Ohio
7. Delaware
8. New Jersey
9. Mississippi
10. Kansas

Official state recognition for small business won't make or break small companies very often, but it can give them a boost from time to time and help create a positive business climate. Programs that provide reliable information or technical assistance, for example, can save business operators both time and money.

INC. surveyed the 50 states to identify those that address the concerns of small companies through small business assistance offices, ombudsmen, statewide small business conferences, standing legislative committees, and governors' advisory councils. Nine states have created new legislative committees in the past year, bringing the number of legislatures with small business committees to 21. What is more, 13 governors have recently formed new advisory councils, bringing to 29 the number of states with that form of small business support.

The number of states committed to purchasing a specified portion of their goods and services from small businesses—usually 5% to 15%—has also increased substantially. Twenty-five states currently have procurement set-aside programs, 10 of which were established in the past year.

Kentucky, New York, and Illinois emerge at the top of the charts for official state support for small business. They are the only three states in the nation with a full array of the programs measured in INC.'s survey. But even more noteworthy is that, in the past year, 25 states have upgraded their small business support activities.



The most improved state is Delaware, which installed four new components to its small business support: an assistance office, an advisory council, a legislative committee, and a procurement program. Almost as impressive is New Hampshire, which added three programs but still lacks an advisory council.

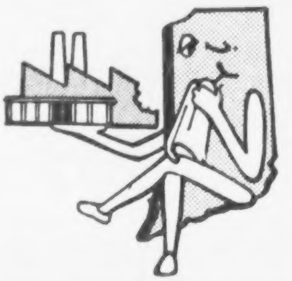
Among the other states demonstrating increased support are Mississippi, Kansas, Rhode Island, Maryland, and Missouri.

Taxes: Indiana takes the smallest bite

1. Indiana
2. New Hampshire
3. Missouri
4. Ohio
5. Tennessee
6. Alabama
7. Florida
8. Texas
9. Arkansas
10. Kansas

As unpleasant as taxes are to many small companies, their importance to a state's overall business climate is seldom on a par with such factors as capital and local resources. Nevertheless, the level of state and local taxes that businesses and individuals must pay tells something about whether it is possible to operate and grow in that state.

Since states tax businesses so differently—by income, payroll, or inventory, for example—and vary greatly in terms of tax credits allowed, state officials and tax experts agree that any direct comparisons are nearly impossible. Instead, INC. focused on the overall level of state and local taxes as related to each $1,000 of personal income—a measure that can be examined on a state-by-state basis. By this measure, Indiana's tax rate of $88 per $1,000 was the nation's lowest, followed by New Hampshire ($92), Missouri ($93), and Ohio and Tennessee (both with rates of $94).



The state with the highest tax was Alaska at $368, although in reality nearly all of the state's revenue is drawn from big energy companies. (In fact, most Alaskans pay no state or local taxes.) New York, where individuals pay $163 per $1,000, was No. 2 , although it has just enacted new rules for start-ups (see page 101). Following New York are Hawaii and Wyoming (both $148) and Massachusetts ($139).

Such tax burdens are comparatively stiff. But tax specialists and economists point out that high state taxes rarely influence a business decision about whether to start up or expand in a particular location—except in the unlikely event that other variables are equal. For one thing, higher taxes can mean better services and schools. "If you can sell 10 times as many widgets in New York as you can in Mississippi or Alabama, you don't mind paying those high taxes," says a national tax partner for a Big Eight accounting firm. "Taxes are usually just the tail," he says, "not the dog."

Bradford W. Ketchum Jr., a senior editor at INC., assisted in the preparation of this section. Anita Harris, a freelance writer, and Carol Holliday Blew, a business analyst, both based in Boston, assisted in research and data analysis.